# JANUARY 1959 ECONOMIC REPORT OF THE PRESIDENT

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## HEARINGS

BEFORE THE

## JOINT ECONOMIC COMMITTEE
## CONGRESS OF THE UNITED STATES

EIGHTY-SIXTH CONGRESS

FIRST SESSION

PURSUANT TO

## Sec. 5(a) of Public Law 304

(79TH CONGRESS)

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JANUARY 27, 28, 29, 30, FEBRUARY 2, 3, 4, 5, 6, 9, AND 10, 1959

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Printed for the use of the Joint Economic Committee

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# JANUARY 1959 ECONOMIC REPORT OF THE PRESIDENT

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TUESDAY, JANUARY 27, 1959

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met at 10:10 a. m., in room P–63, the Capitol, Hon. Paul H. Douglas (chairman) presiding.

Present: Senators Douglas, O'Mahoney, Williams; and Representatives Reuss, Curtis, and Widnall.

Also present: Roderick H. Riley, executive director; John W. Lehman, clerk.

The CHAIRMAN. The President's annual economic report to the Congress has been referred to this committee for study as provided in the Employment Act of 1946. Under that act the committee is to study the main recommendations and advise the Congress of its views about them on or before March 1. Without objection I would like to insert in the record at this point a schedule of the entire set of hearings accompanied by questions supplied to various witnesses as suggestive but not limiting the scope of the hearings.

(The material referred to is as follows:)

January 27 (Tuesday), Old Supreme Court Chamber (P–63, Senate wing, the Capital), 10 a.m.—Council of Economic Advisers:

Raymond J. Saulnier, Chairman, accompanied by
Karl Brandt, and
Paul W. McCracken, members

1. What are the levels of employment, production, and purchasing power needed in 1959 to carry out the objectives of the Employment Act?
2. What are the current and foreseeable trends in employment, production, and purchasing power?
3. What assumptions with respect to prices, national income, personal income, corporate profits, and the like, underlie the President's Economic Report? Are these assumptions consistent with those upon which the budget is based? Are these assumptions consistent with attainment of Employment Act objectives in calendar 1959?
4. In discussing the economic outlook for 1959 and in formulating its recommendations, does the Economic Report take account of likely developments with respect to the broad outlines of monetary and credit policy to be expected this year? Do you expect that realization of the report's program and the Employment Act objectives in 1959 will require any significant changes in monetary policy during the year? If so, what changes would be desirable?
5. With the advantage of hindsight, do you now think different public policies should have been adopted after mid-1957? If so, what changes would you have made?

January 28 (Wednesday), room 362, Old House Office Building, 10 a.m.—the Federal budget:

Maurice H. Stans, Director, Bureau of the Budget.

1. What are the major changes in expenditures and revenues contemplated in the President's budget for fiscal year 1960?

2. What assumptions with respect to prices, national income, personal income, corporate profits, and the like, underlie the President's budget?

3. In preparing the budget how have the objectives of the Employment Act of 1946 been taken into account; how is the budget expected to contribute to their achievement?

4. What effect are changes in the budget estimated to have on the gross national product and on Federal revenues?

January 29 (Thursday), Room 362 Old House Office Building, 10 a. m.—Panel: Economic Outlook:

1. What is the outlook for labor force, hours of work, and productivity in comparison with long-run trends?

2. What are the likely trends in receipts and expenditures of Federal, State, and local governments?

3. What is the outlook for business fixed investment; for international trade and investment; residential construction; for inventories?

4. What is the outlook for consumer buying of durables, nondurables, and services?

5. What is the outlook for prices?

Labor force, etc.:
- Ewan Clague, Commissioner, Bureau of Labor Statistics, Department of Labor

Government demand:
- Louis J. Paradiso, Assistant Director and Chief Statistician, Office of Business Economics, Department of Commerce

Housing investment and demand:
- Robinson Newcomb, consulting economist

Investment demand:
- Martin R. Gainsbrugh, chief economist, National Industrial Conference Board

Inventories and consumer demand:
- Irwin Friend, professor of economics, University of Pennsylvania

International trade and investment:
- William F. Butler, vice president, Chase Manhattan Bank

Agriculture:
- Oris V. Wells, Administrator, Agricultural Marketing Service, Department of Agriculture
- Louis H. Bean, consulting economist

January 30 (Friday), room 362 Old House Office Building, 10 a. m.—Panel: Policy Implications for the Economic Outlook:

1. What, if any, changes in governmental economic policies are called for in the year ahead?

2. What would you regard as the proper division of labor between tax policy and monetary policy as instruments of economic stabilization during the coming year?

3. What relative emphasis should these policies place on the expansion of investment and of consumption?

- Richard A. Musgrave, professor of economics, University of Michigan
- William J. Fellner, professor of economics, Yale University
- Walter W. Heller, professor of economics, University of Minnesota
- Benjamin U. Ratchford, professor of economics, Duke University
- Paul A. Samuelson, professor of economics, Massachusetts Institute of Technology
- Herbert Stein, director of research, Committee for Economic Development
- J. A. Bierne, president, Communications Workers of America

February 2 (Monday), 457 Senate Office Building, 10 a.m.—Panel: Factors Affecting Economic Growth:

1. When we talk of economic growth, do we mean expansion of GNP? or of GNP per capita? or of productive capacity?

2. What are the principal factors explaining the growth that has taken place?

3. How important a factor is research and development? What evidence do we have that research and development "pays off" in clear-cut contributions to industrial and economic growth? What contribution to national economic growth can be expected to result from the development of specific areas and regions?

4. Can we count on the contribution of these factors to maintenance of growth to continue in at least the same degree as in the past? What basic changes, if any, in public policies would contribute to providing the conditions in which growth-impelling forces would be encouraged.

5. Can we have a higher rate of growth in the future without devoting to capital formation a larger proportion of our resources than in the past? Would not a faster rate of growth require an increase in the rate of saving? What problems of income distribution must we expect to find associated with a relative increase in the rate of expansion of our productive capacity?

6. Would devoting a larger proportion of our resources to capital formation give rise to greater difficulties in maintaining stability in the general level of prices and in the rate of employment and other resource use?

7. The word "dynamic" is frequently used to describe the American economy. What implications are there in the dynamic characteristics of the economy with respect to the opportunities to expand our productive capacity? for limitations upon such expansion? What account should be taken of these implications in comparing the growth of the U.S. economy with that of a less dynamic economy? How is the comparison of the growth of our economy with that of the Soviet Union affected?

Harold J. Barrett, development department, E. I. du Pont de Nemours & Co.
Robert Eisner, professor of economics, Northwestern University.
Joseph L. Fisher, associate director and secretary, Resources for the Future.
Daniel Hamberg, professor of economics, University of Maryland.
Hans Heymann, Jr., economist the Rand Corp.
Robert E. Johnson, economist and actuary, Western Electric Co.
Herbert E. Striner, economist, operations research office, the Johns Hopkins University.
Alan T. Waterman, Director, National Science Foundation.

February 3 (Tuesday), 457 Senate Office Building, 10 a.m.—Panel: The Structure of Business and the Employment Act of 1946:

1. How would you evaluate the contribution of current antitrust policy to attainment of the Employment Act's objectives of economic growth and stability? What revisions in these policies would provide opportunity for a greater contribution?

2. Some examinations of recent U.S. experience suggest that relative immobility of important types of resources is an important factor in rising costs and, therefore, upward price pressures. One example is the hoarding of skilled and technical labor services needed in connection with a good deal of investment in plant and equipment. To what extent are such barriers reflections of concentration of economic power? Can antitrust policy be more effectively directed toward reducing the barriers to free resource movement?

3. The strong market position of large business and the bargaining power of large labor organizations have been identified in many discussions as contributing importantly to inflationary tendencies apparent in recent years. To what extent can this interpretation be factually supported? If this be the case, what changes in antitrust and related policies are called for to assure that such power is appropriately reduced or otherwise modified in the public interest?

Solomon Barkin, director of research, Textile Workers Union of America.
Padraic P. Frucht, economist, Chamber of Commerce of the United States.
Horace M. Gray, professor of economics, University of Illinois,
Alfred E. Kahn, professor of economics, Cornell University.
Mark S. Massel, senior staff member, the Brookings Institution.

February 4 (Wednesday), 457 Senate Office Building, 10:30 a.m.—Antitrust Policy and Employment Act Objectives:

Victor R. Hansen, Assistant Attorney General in charge of the Antitrust Division, Department of Justice; accompanied by Robert Bicks, first assistant to Mr. Hansen.

1. What consideration is given, in the shaping and application of antitrust policies, to the contribution they can make to attainment of the objectives of the Employment Act of 1946?

2. Under what are termed additional measures for economic growth (p. 53 of the Economic Report), the President includes three recommendations to strengthen antitrust policy. In your opinion, how would economic growth be promoted by these measures?

3. The Economic Report also includes the statement that "self-discipline and restraint [by labor and management] are essential if agreements consistent with reasonable stability of prices are to be reached within the framework of [our] free competitive institutions." If, as this seems to imply, our free competitive institutions are not functioning sufficiently well to create adequate market restraints, is this because antitrust policies are not being vigorously enough pursued or because the statutes are too limited? If the latter, will the measures recommended by the President be sufficient to overcome the deficiencies of the law?

4. To what extent do you believe inflationary price movements result from restraints on the freedom of enterprise, noncompetitive market practices, and immobility of resources, compared with inadequate fiscal and monetary restraints?

February 5 (Thursday), 457 Senate Office Building—Fiscal Policy for the Coming Year, 10 a.m.:

Robert B. Anderson, Secretary of the Treasury.

1. What would you regard as the proper division of labor between tax policy and monetary policy as instruments of economic stabilization during the coming year?

2. Is the present structure of the Federal tax system adequate in light of the Nation's economic growth and stability requirements? If not, what changes would you recommend?

3. Under what circumstances can we reduce Federal taxes? What are the prospects for realizing these circumstances?

4. What do you foresee as the Treasury's principal debt-management problems in the year ahead? What effect on interest rates and the availability of credit to sensitive sections of the market, such as housing, do you anticipate from debt-management operations during 1959? What assumptions about the broad outlines of monetary policy underlie the Treasury's debt-management program for 1959?

Fiscal and Budgetary Policy Recommendations, 2:30 p.m.:

Gerhard Colm, chief economist, National Planning Association.

February 6 (Friday), 457 Senate Office Building—Monetary and Credit Policy for the Coming Year, 10 a.m.:

William McC. Martin, Jr., Chairman, Federal Reserve Board.

1. What do you regard as the proper division of labor between tax policy and monetary policy as instruments of economic stabilization during the coming year?

2. What is the current policy of the monetary authorities?

3. What, if any, elements exist in the current situation which suggest or might permit a resurgence of inflationary forces in the next 12 or 15 months?

4. If price movements during 1959 follow the 1958 pattern, would an easier monetary and credit policy be in order? What program would you recommend as to priority and specific actions in the fiscal and monetary fields for 1959?

5. With the benefit of hindsight, do you agree with the contention that monetary and credit policy could and should have been eased some months prior to the fourth quarter of 1957?

Monetary and Credit Policy Recommendations, 2:30 p. m.:

Seymour E. Harris, chairman, department of economics, Harvard University.

February 9 (Monday), Old Supreme Court Chamber (P-63, Senate wing, Capitol).

Panel: Labor and Management Comments on the Economic Report:

Labor comments:

10 a.m.: Walter Reuther, vice president, American Federation of Labor-Congress of Industrial Organizations

Management comments:

11 a.m.: Walter Fackler, Department of Economic Research, Chamber of Commerce of the United States

11:30 a.m.: Ralph Robey, economic adviser, National Association of Manufacturers

Panel: Additional Comments by Group Representatives, 2 p.m.:

American Farm Bureau Federation:

Roger Fleming, secretary-treasurer

Federal Statistics Users' Conference:

Vincent A. Perry, vice chairman

National Farmers Union:

Ralph Bradley, State president of the Illinois Farmers Union, representing the National Farmers Union.

National Grange:

Roy Battles, assistant to the master

National Independent Union Council:

Roger M. Rettig, president

United Mine Workers of America:

Michael F. Widman, Jr.

Committee for Economic Development:

T. V. Houser, Chairman, Research and Policy Committee

February 10 (Tuesday), 457 Senate Office Building, 10 a.m.—the Defense Department budget and plans:

W. J. McNeil, Assistant Secretary of Defense (Comptroller).

1. What significant changes in the Department of Defense program are included in the budget for fiscal 1960? What impact on the total level and on the character of economic activity do you anticipate from these changes?

2. What pattern of defense expenditures and contract placement, by quarters, is contemplated in the budget for fiscal 1960?

3. What criteria were followed in arriving at the total budget proposed for national defense? For apportioning this total among various programs?

Means, Gardner C.

The CHAIRMAN. This morning the committee will hear from the Council of Economic Advisers. We are very happy to welcome you gentlemen. The hearing will be conducted under the same general ground rules which we have established in the last several years, namely the meeting will be held in executive session, with a transcript taken of those parts of the meeting which the Council feels will not jeopardize its position as staff adjunct of the Office of the President. At any point in the hearing, when the Council feels it is entering into an area which threatens to jeopardize that position, it will be given permission to go off the record, although from the experience of recent years I do not anticipate that that will be necessary.

The Council will subsequently be given the privilege of editing the transcript, and the edited transcript will be made a part of the printed hearings for the benefit of committee members who cannot attend today, other Members of Congress, and the public in general. The Council is, of course, welcome to provide any additional materials which it feels will be helpful to those who peruse the printed record.

Dr. Saulnier, you may proceed as you wish. Do you have a prepared statement?

## STATEMENT OF RAYMOND J. SAULNIER, CHAIRMAN, ACCOMPANIED BY PAUL W. McCRACKEN, AND KARL BRANDT, MEMBERS, COUNCIL OF ECONOMIC ADVISERS

Mr. SAULNIER. Mr. Chairman, I come here with no prepared statement but will be glad to proceed at once with such questions as the committee wishes to ask.

I would like first to introduce my two colleagues, Dr. McCracken; and Dr. Brandt, who is a new member of the Council of Economic Advisers.

The CHAIRMAN. You have aided and are acquainted with the President's budget?

Mr. SAULNIER. I am, sir.

The CHAIRMAN. Do you agree with the estimates that the revenues for the fiscal year 1959–60 will amount to $77 billion?

Mr. SAULNIER. I think that is a reasonable estimate.

The CHAIRMAN. And you endorse it?

Mr. SAULNIER. I do.

The CHAIRMAN. Now, what is the assumption of the level of corporate profits?

Mr. SAULNIER. Well, I don't know that there is any single assumption.

The CHAIRMAN. Well, it is estimated that the receipts from the corporation income tax will be $21½ billion.

Mr. SAULNIER. That is right.

The CHAIRMAN. Now, what is the estimated total of corporate profits upon which that estimate of $21½ billion in tax receipts is made?

Mr. SAULNIER. Well, it is based, of course, on an expectation of a substantial improvement in corporation profits. And as you know, corporate profits have already rebounded rather sharply.

The CHAIRMAN. Well, may I ask this. What is the figure—what is the estimate of corporate profits?

Mr. SAULNIER. I don't know that I can answer that.

The CHAIRMAN. Is any member here able to?

Mr. SAULNIER. I don't know that I can answer that as a specific number. Of course corporate profits tax receipts will be just a bit under 50 percent of the corporate profits total. But the precise percentage that one will use here can properly vary from one year to another.

The CHAIRMAN. Well, it is my understanding that the Treasury estimates corporate profits for the fiscal year 1959–60 at $47 billion. That was given out at a press conference. I will ask the staff if that is correct.

Mr. RILEY. That is correct.

Mr. SAULNIER. That is for the calendar year 1959.

The CHAIRMAN. Yes, calendar year 1959. Well, the estimate of income from the corporate profits—income to the Government from the corporate profits tax for fiscal 1960—is based, is it not, upon the estimate of net corporate profits for the calendar year 1959?

Mr. SAULNIER. That is correct.

The CHAIRMAN. Yes.

So the assumption is made—I think this is true and the record should show it—that net corporate profits for calendar 1959 will be approximately $47 billion. I think that is correct.

Now, in the monthly Economic Indicators, January 1959, on page 8 which you have submitted to us, there is a statement of corporate profits before taxes for the second quarter of 1958 as being $32 billion.

This assumption, therefore, of the Treasury is that profits for calendar 1959 will be almost 50 percent greater than profits for the second quarter of calendar 1958. Isn't that correct?

Mr. SAULNIER. That is correct, Mr. Chairman.

The CHAIRMAN. Isn't that somewhat optimistic?

Mr. SAULNIER. No, I don't believe it is unduly optimistic. I don't believe it is at all an unreasonable estimate. As you may know, the current estimates of corporate profits for the last quarter of this year are in the neighborhood of $44 billion.

The CHAIRMAN. Corporate——

Mr. SAULNIER. At an annual rate.

The CHAIRMAN. $44 billion.

Mr. SAULNIER. That is correct.

The CHAIRMAN. Did they jump from 32——

Mr. SAULNIER. They jumped from the low of a bit under $32 billion in the first quarter of 1958.

The CHAIRMAN. Do you have those figures?

Mr. SAULNIER. You will find them, Mr. Chairman, in the Economic Report. Not in Economic Indicators.

The CHAIRMAN. Well I am somewhat puzzled by this, because you prepare Economic Indicators for us, and the figures which you submit to us don't go beyond the second quarter.

Mr. SAULNIER. Well, that to the best of my knowledge has been true for a good many years. But we do give the annual figure in the Economic Report.

The CHAIRMAN. Well, I hope this may be true. I don't believe in undue scrutinizing of past prophesies; but you may remember that last year when you were before us, you estimated that the President's estimates of receipts of $73 or $74 billion would hold good. I expressed some doubt at the time.

Mr. SAULNIER. Doubt as to the course of corporate profits, Senator?

The CHAIRMAN. Yes.

Mr. SAULNIER. I don't recall any doubts of yours on that point.

The CHAIRMAN. I refer you to page 9 of the hearings last year.

Mr. SAULNIER. Your doubts with respect to the movement of corporate profits?

The CHAIRMAN. Yes.

If you will turn to the hearings of last year, page 9, I will read them:

I am trying to bring out this: Aren't you really being too optimistic in your belief that revenues are going to hold up? To the degree that you are, receipts from excise taxes would be down. And while it is true the income tax and corporation tax payments will in the main be based on calendar 1957, which is over with, there will be some payments on current receipts, current income.

I am sure your faces would be quite red if on the 1st of July, the 6th or 7th of July, instead of a deficit of $400 million, which you endorse, which you are now endorsing, you have a deficit of over a billion or $2 billion; that would be quite an error.

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Now, as it turns out, the deficit for fiscal 1958 was almost $3 billion and the deficit for fiscal 1959 almost $13 billion, and the corporate profits for 1958 fell off so that total receipts of the Government, instead of being the $73 or $74 billion which the President had estimated, it is believed will fall to $68 billion. And this required the administration to come to the Congress and ask for an increase in the debt limit.

Mr. SAULNIER. Yes.

The CHAIRMAN. I am not interested in scoring points on you. But I do want to point out that last year when you were optimistic about the budgetary figures and I was pessimistic about the figures, events have proved me to be right and proved you to be wrong. And, therefore, I wonder if this past experience shouldn't make you a little bit more cautious in your estimates of this year.

Mr. SAULNIER. Well, just let me continue with the reading of last year's record. I went on and said in response to your reference about revenues:

> If my face is red at that time, sir, it will be red not because of an unrealized statistical estimate but rather because our economy has not shown the recovery which I think it will.

And I am glad to say, Senator, that I have found no occasion to blush over the performance of our economy. And that, I think, is the important thing for us.

The CHAIRMAN. You think that the President's estimate that budgetary receipts would be $73 billion or $74 billion for fiscal 1959 was correct?

Mr. SAULNIER. I am quite prepared to say, Senator, that I was very much surprised at the sharp decline in corporate profits.

The CHAIRMAN. That is what I was warning you about.

Mr. SAULNIER. As a result of the recession?

The CHAIRMAN. Yes, that is what I was warning you about.

Mr. SAULNIER. I hadn't realized that you were pinpointing your observations to corporate profits.

The CHAIRMAN. Yes, indeed.

Mr. SAULNIER. It is hard for me to read that in the record.

But I learned something from last year's experience. And I would hope that we have all learned something from it.

And now, just as we had a very sharp decline in corporate profits during the recession, I think we can also expect a rather sharp rebound as our economy recovers. Indeed, to the best of my knowledge that is the typical professional appraisal at this time.

The CHAIRMAN. So you stand on the estimate of receipts from corporate income tax at $21½ billion.

Mr. SAULNIER. I think it is a quite reasonable estimate, Senator.

The CHAIRMAN. And your estimate of receipts from the personal income tax?

Mr. SAULNIER. I think it is also reasonable.

As a matter of fact, Senator, I wouldn't be at all surprised if it turns out to be a bit on the conservative side.

The CHAIRMAN. The estimate for them is $40.7 billion?

Mr. SAULNIER. Yes.

The CHAIRMAN. Now, on what figure of personal incomes is that based?

Mr. SAULNIER. The figure that is being used in connection with the corporate profits figure that you have mentioned——

The CHAIRMAN. No, I am now speaking of individuals.

Mr. SAULNIER. Yes. The personal income figure is around $375—$374 or $375 billion.

The CHAIRMAN. Now, in order to give everyone a chance, I think I should call on the other members of the committee. I don't think any of us should take more than 10 minutes at a time. I have exhausted my 10 minutes.

Representative CURTIS. Mr. Chairman, I want to apologize for being late. Did Mr. Saulnier read a statement?

The CHAIRMAN. No.

Representative CURTIS. This is just an interrogation?

The CHAIRMAN. Yes.

Representative CURTIS. I haven't caught up to what is going on here. So I will pass.

The CHAIRMAN. Congressman Reuss.

Representative REUSS. Dr. Saulnier, last year at about this time when you were testifying on last year's economic report, unemployment was reported at 3,374,000—some 5 percent of the labor force. You stated at that time that you were in favor of expansion policies.

I think your actual words were:

> The simple figure of unemployment in relation to the civilian labor force that we can read out of the plainest table on statisticians is sufficient for my purpose. I am here today as an expansionist so far as economic policies are concerned.

Incidentally, I agreed with your expansion view last year.

Our latest figures show that unemployment stands today at 6.1 percent of the labor force, with more than 4,100,000 unemployed.

My question, sir, is: Are not expansionist measures as necessary now as they were a year ago?

Mr. SAULNIER. I remember that very well, Congressman Reuss.

I am glad to say that, broadly speaking, the policies followed from that time were expansionist policies. And they had rather good effects all around. As you know, our economy registered an early and a good recovery. It came a bit earlier than some people expected. I must say that it came a bit earlier than I expected myself. I think that if I had been called upon last January to specify my expectations, I would have placed the trough a bit later than April.

Now, since that time we have had a good recovery. In terms of production, it has gone ahead very well.

In terms of employment, as is characteristic of the recovery period, it has gone ahead a bit less rapidly. But broadly speaking, Congressman Reuss, the expansion of employment and the reduction of the ratio of unemployment to the labor force has been about in line with historical experience. And it was in order to illustrate that very point that we thought it would be useful to include a chart in the Economic Report to which I would like to refer for a moment. It shows the movement of employment and of the unemployment rate.

Representative REUSS. On what page?

Mr. SAULNIER. Page 14, sir.

In the present recovery and in 1953–55 and 1948–50 periods. But let me point out the behavior of the December figure. You will notice that it drops off a bit. And the unemployment ratio rose just a bit.

Now, we have looked pretty closely at this, which is not the sort of thing that we like at all. However, I am not inclined to place a great deal of emphasis on this one month's record.

Representative REUSS. Particularly concerned over——

Mr. SAULNIER. Yes, that December zig. That decline was in contract construction employment. At the same time we got this figure, showing the decline in employment, we got a figure on housing starts at 1,430,000 or 1,440,000. I must say this baffled me some. And I am postponing my judgment on this for a bit.

But let me say that if I found those figures for January and for February continuing to lag substantially, I would be concerned.

Representative REUSS. Then presumably under the Employment Act, you would send to this committee some outward and visible sign of the signal.

Mr. SAULNIER. The Council of Economic Advisers is called upon to advise the administration on these matters. And we would be giving our speeches on the subject.

Representative REUSS. In addition to advising the Executive and giving speeches, doesn't the Employment Act in section 3(b) state—here I read:

> The President may transmit from time to time to the Congress reports supplementary to the Economic Report——

Mr. SAULNIER. Yes.

Representative REUSS (continuing):

> each of which shall include such supplementary or revised recommendations as he may deem necessary or desirable to achieve the policy declared in section 2.

Wouldn't it be a good idea under this section, even though it says may rather than shall, to report to the Joint Economic Committee any major changes in the economic outlook?

Mr. SAULNIER. It would, yes. Absolutely.

Representative REUSS. If such changes occurred?

Mr. SAULNIER. Absolutely, yes. Now you remember there was considerable discussion of this last July or August when we were just about at the end of the congressional session. We would have had, oh, I don't know, maybe a week and a half or 2 weeks, to prepare a midyear economic report. Our economy was in recovery. And at that time, Congressman Reuss, I expressed the feeling that such a report would not be useful.

Now, this is entirely without prejudice to my views as to the utility of such a special report at some other time.

Representative REUSS. Just a final question since my time is almost up.

Am I right, then, Dr. Saulnier, in my interpretation of your answer to my question. The question was:

> Why is it that a year ago with 5 percent of the labor force unemployed, you were worried enough to favor expansionist policies; yet today with more than 6 percent of the labor force unemployed, you not only do not advocate expansionist policies, but recommend mildly restrictionist policies?

Is it a correct inference from your testimony that this difference in view derives from your judgment that unemployment situation is improving, at the present time, whereas a year ago it was deteriorating?

Mr. SAULNIER. Absolutely.

Representative REUSS. Is that a fair summary?

Mr. SAULNIER. Yes, indeed. As you will see from the contour of the movement of the ratio of unemployment to the labor force, as shown on page 24, I was here last when the ratio was rising. And it continued to rise. It rose, in fact, to over 7 percent. And during that entire period the Council was using its best offices to encourage the adoption of measures which we thought would help to cushion the decline and to promote recovery. And that did happen.

Representative REUSS. Thank you very much. Thank you, Mr. Chairman.

The CHAIRMAN. Congressman Widnall.

Representative WIDNALL. Dr. Saulnier, maybe this is a question I should be able to answer myself. But how do you actually count the unemployment? Who is included as unemployed? Can you give a simple answer to that?

Mr. SAULNIER. Well, the computation of unemployed is roughly as follows: We have to have a figure of both people at work—that is, the total number of employed persons—and a figure of the total number of people who are in the labor force. And it is a simple subtraction of one from the other.

The calculations of both employment and labor force are made by the Census Bureau, on the basis of house-to-house checks of a sample of households. The enumerators find out how many people regard themselves as in the labor force.

That is, are able to work and are looking for work and prepared to accept work.

Then the next question is: How many of these people are employed? And by simple subtraction, we get an unemployment figure.

Representative WIDNALL. How often are the figures of the potential workers checked?

Mr. SAULNIER. They are taken monthly.

Representative WIDNALL. Is that just a sampling?

Mr. SAULNIER. It is a sampling; yes, sir. We have, I think, a pretty good degree of reliability in the sample.

Now, we do have two different figures of employment. The figures that I have described and an estimate of employment made on a sampling basis by the Bureau of Labor Statistics.

The latter is based on the payrolls of business firms.

Representative WIDNALL. May I ask this question.

X retires from business or from a civil service position and is on retirement pay. Yet that person wants to work. Is that person counted as unemployed?

Mr. SAULNIER. If he is seeking work, he is counted as a member of the labor force.

Representative WIDNALL. So that actually, you could have two or three million people who are on retirement pay today who are counted as unemployed if they are looking, for just the spot that they want to fit into to supplement their retirement income. Isn't that possible?

Mr. SAULNIER. We have a large number of such people, doubtless a very large number of people, who are counted as in the labor force, but who are not at work and are, therefore, counted as unemployed.

Yet we would probably regard them as being in a quite different economic status, some of these people, from the family man, with a number of dependents, who is out of work and desperately in need of a job. In other words, there are all degrees of seriousness of unemployment, as felt by the individual.

Representative WIDNALL. Well, in situations like this, how are these people counted? The automobile factories shut down, and the men are unemployed. Many of those people have had for some time Saturday and Sunday jobs including their own little businesses that they operate. Are they counted as employed or unemployed?

Mr. SAULNIER. There is an important difference between the way employment is calculated by the Bureau of Labor Statistics and the way it is calculated by the Census Bureau.

If a fellow has a job, any job, he is counted as employed. He may have two jobs. He may have three jobs. But he is one employed person to the Census. But for the BLS, where you go to payrolls, and you get the count of employed people on payrolls, that duplication is not eliminated. Accordingly, in a recession period there is a sharper decline in the BLS estimate of employment than in the Census estimate.

In the BLS estimates, when a person loses one of his two jobs, it is like one person falling out of the employed population. This would not be the case in the Census figures.

Representative WIDNALL. I see.

Mr. SAULNIER. In the Census estimate he would still be employed, even though he had one job rather than two.

Representative WIDNALL. Thank you.

That is all.

The CHAIRMAN. Senator O'Mahoney.

Senator O'MAHONEY. Thank you, Mr. Chairman. I am sorry that I wasn't here at the beginning of the session. I had to be in attendance at a meeting of the National Petroleum Council, which is meeting this morning to determine upon its new relationship with the Government.

The petroleum industry of course is very much concerned about the importation of foreign oil. You are familiar with that problem.

Mr. SAULNIER. Yes; I am.

Senator O'MAHONEY. And I was calling the attention of the group to the fact that the interest on the national debt as represented by the President's budget is about five times the expenditure on the development of natural resources which includes the handling of water resources and the handling of the General Leasing Act on the public domain.

Now, the interest on the national debt as computed by the President's budget is $8,096 million. It constitutes, according to the Budget in Brief, 10½ percent of the total budget as submitted for fiscal 1960 whereas natural resources constitute only 2⅖₀ percent of that figure.

The New York Times yesterday reported that the 1-year maturities of the Government bonds, notes and bills, direct obligation to the Government amounts to $80,624,925,474. The interest on these obligations is increasing because the Treasury has not only asked an increase on the ceiling of the national debt in order to enable it to sell additional securities, but it is selling bills and notes to raise cash because the revenue is not sufficient. And of course the interest rate is increasing.

Mr. SAULNIER. After a very sharp decline.

Senator O'MAHONEY. No. I mean the interest rate that we are paying is increasing.

Mr. SAULNIER. Yes.

Senator O'MAHONEY. It is now about 4 percent.

Mr. SAULNIER. After having fallen, the short term rate, to a little over a half of 1 percent.

Senator O'MAHONEY. That was a long time ago.

Mr. SAULNIER. No. That was a few months ago.

Senator O'MAHONEY. A few months ago?

Mr. SAULNIER. Yes.

Senator O'MAHONEY. I see. How much of the national debt?

Mr. SAULNIER. Well, the entire treasury bill portion. We carry a little chart, Senator, on that, in the Economic Indicators. It is a rather useful picture. It is on page 29. In fact, it is quite a dramatic picture of the happenings of 1958.

Senator O'MAHONEY. Yes, I have seen that.

Mr. SAULNIER. That is the drop I was referring to.

You see that the Treasury bill rate in 1957 was just short of three and one-half.

Senator O'MAHONEY. Well, when it comes down to less than 2 percent, it is getting pretty close to greenbacks.

Mr. SAULNIER. I would regard it as still a long way from greenbacks, Senator.

Senator O'MAHONEY. Greenbacks have no interest rate at all. But on the other hand we know that the Government arranges to have the withholding taxes withheld by every employer in the country deposited in banks en route to the Treasury. In any event the banks are permitted to charge the Government interest on the Government's money which is held en route to the Treasury.

Mr. SAULNIER. There is a deposit account, yes, that is held in the banks. It is characteristic of any enterprise collecting large sums. The receipts are held in deposit banks throughout the country.

Senator O'MAHONEY. Well, there is quite an issue as to whether or not Congress shall by legislation at least decrease the amount of interest that the banks collect——

Mr. SAULNIER. I didn't hear.

Senator O'MAHONEY. At least decrease the interest on Government money held by the banks. But that is not the point that I am driving at. I don't want to be diverted.

What I am emphasizing is that the national debt is increasing; the annual interest upon the national debt is increasing, so that it is much greater than the amount that is expended for the conservation of water and of natural resources. At the same time the Treasury is obliged to sell bonds at a discount. And I am wondering how in this general situation you believe that we are getting a balanced budget and that the receipts of the Government are likely to increase?

This budget shows, for example—let me turn to page 40 of the Budget in Brief—a table showing authorizations, expenditures, and balances, 1960 estimate.

Mr. SAULNIER. Yes.

Senator O'MAHONEY. Now, the carryover which will go into 1960 is $72,800 million. That is the authorizations which have already been made by Congress, but which have not yet been obligated. Am I right?

Mr. SAULNIER. That is correct, sir.

Senator O'MAHONEY. The budget which is presented to us is for new obligational authority for 1960. The total of the two is $149,-600 million.

Are we getting receipts enough to really balance the budget when it has reached that very high total?

Mr. SAULNIER. We are anticipating receipts, Senator, that will be roughly equivalent to the expenditures which the budget estimates or projects as being made in the fiscal year 1960. Of course the question of balance here is a question of the balance between receipts and actual expenditures.

Senator O'MAHONEY. Now those receipts will come primarily from the tax income, will they not?

Mr. SAULNIER. That is right, sir.

Senator O'MAHONEY. I want to turn to the table of corporate profits on page 8. The report and the budget report both seem to tell the Congress that corporate taxes will increase. I point out that for the first 3 quarters—no, the first 2 quarters—of 1958, the corporate taxes, the dividend payments, and the undistributed profits all seem to be lower than at any time since 1952.

Mr. SAULNIER. Yes; that is correct.

But, Senator, let me say that in an earlier discussion with Senator Douglas, I pointed out that there had been a very sharp—at least we estimate that there has already been a very sharp—rebound of corporate profits in the third and the fourth quarters of this year.

Senator O'MAHONEY. That I know is an estimate.

Mr. SAULNIER. Yes.

Senator O'MAHONEY. I am trying to find on what you base that estimate.

Mr. SAULNIER. Well, it is based——

Senator O'MAHONEY. I find article after article in the business press which doesn't seem to agree with that estimate.

Mr. SAULNIER. I am unaware of any broad disagreement with this projected recovery of profits. But we do not have a very large amount of current data on corporate profits and we could be wrong.

Senator O'MAHONEY. Well, let me read to you from the column of J. A. Livingston, a very well-known columnist on business, which I took from the Washington Post of January 25.

This is his final reference to this financial problem:

> The Treasury recently put out two new issues. $750 million of 4 percent, 21-year bonds, and $2½ billion of 3½ percent, 16-month notes. Within a week, the four sold down one-half point below the offering price of 99.
>
> Government bonds are selling to yield better than 4 percent. This makes them attractive for savings banks and insurance companies.

Let me say here that the Fact Book of Life Insurance shows that companies' holdings in Government bonds have suffered a very severe decline. The companies don't begin to have the confidence in Government bonds now that they used to have.

Mr. SAULNIER. I think you will find that their holdings increased in 1958. Just a moment, Senator, I will find it.

Senator O'MAHONEY. I didn't bring the Fact Book with me. But I will get the table from the Fact Book of Insurance and insert it in the record. (See p. 16.)

Mr. SAULNIER. Let me refer to a table here in one of the appendixes to the Economic Report, the appendix on financial developments.

You will find table C–16 on page 110 which shows the net change in the holdings of life insurance companies of Federal debt. In the first half of 1958——

Senator O'MAHONEY. I am looking at table 16.

Mr. SAULNIER. C–16.

Senator O'MAHONEY. C–16, commercial banks, Federal Reserve banks, mutual savings, and insurance companies.

Mr. SAULNIER. You will see, Senator, that in the first half of 1958 their holdings were reduced by $300 million. And in the second half of the year—and this again is based on estimate—they increased by half a billion dollars.

Senator O'MAHONEY. Well, that is only a fraction of what they held 10 years ago.

Mr. SAULNIER. This is not the total volume of their holdings, Senator. This is the net change in their holdings in 6-month periods.

Senator O'MAHONEY. Yes.

Mr. SAULNIER. And you will find that their overall holdings are very much larger in the aggregate than they were.

Senator O'MAHONEY. I am sure you are mistaken about that.

If the figures that I have found in the insurance companies' Fact Book are correct, you are mistaken about that.

Mr. SAULNIER. I am afraid we don't have complete information on these matters in the Economic Report.

Senator O'MAHONEY. Oh, I know. I was just trying to get some.

Mr. SAULNIER. I am sorry we don't have a total for insurance companies, separately.

But if you go back to 1941 you will see that insurance company holdings were $8 billion. They rose to $24 billion in 1945. And in September 1958 they were close to $12 billion.

At the end of the war a considerable volume of Government securities were sold by the insurance companies. They were taken up by other investors, of course, and the insurance companies put the funds into real estate mortgages.

Senator O'MAHONEY. Well, as you say, this table on page 42 of the Treasury Bulletin shows that in September 1958, insurance companies' holdings amounted to $11.9 billion, whereas, back in December of 1946 their holdings were $24.9 billion.

Mr. SAULNIER. Go back a bit further, Senator.

Senator O'MAHONEY. I will be glad to. But I also call your attention to the fact that I have the Insurance Fact Book. I will have that inserted in the record here, and I will send it to you. I just don't want to be diverted from what I was talking about.

(The material referred to follows:)

The table to which I refer, reproduced below, is to be found on page 66 of the Life Insurance Fact Book for 1958. The table to which Mr. Saulnier referred is from an issue of the Treasury Bulletin and includes all insurance companies. The table from the Fact Book deals solely with life insurance companies. Their holdings of U.S. securities have decreased from $20,583 million in 1945 to $7,029 million in 1957.

*Distribution of assets of U.S. life insurance companies*

[000,000 omitted]

AMOUNT

| Year | U.S. Government securities | Foreign government bonds | State, provincial, and local bonds | Railroad bonds | Public utility bonds | Industrial and miscellaneous bonds | Stocks | Mortgages | Real estate | Policy loans | Miscellaneous assets | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1917 | $70 | $163 | $329 | $1,813 | $113 | $49 | $83 | $2,021 | $179 | $810 | $311 | $5,941 |
| 1920 | 830 | 169 | 350 | 1,775 | 125 | 49 | 75 | 2,442 | 172 | 859 | 474 | 7,320 |
| 1925 | 627 | 154 | 530 | 2,238 | 687 | 97 | 81 | 4,808 | 266 | 1,446 | 604 | 11,538 |
| 1930 | 319 | 160 | 1,023 | 2,931 | 1,631 | 367 | 519 | 7,598 | 548 | 2,807 | 977 | 18,880 |
| 1935 | 2,853 | 189 | 1,685 | 2,625 | 2,114 | 575 | 583 | 5,357 | 1,990 | 3,540 | 1,705 | 23,216 |
| 1940 | 5,767 | 288 | 2,392 | 2,830 | 4,273 | 1,542 | 605 | 5,972 | 2,065 | 3,091 | 1,977 | 30,802 |
| 1945 | 20,583 | 915 | 1,047 | 2,948 | 5,212 | 1,900 | 999 | 6,636 | 857 | 1,962 | 1,738 | 44,797 |
| 1950 | 13,459 | 1,060 | 1,547 | 3,187 | 10,587 | 9,526 | 2,103 | 16,102 | 1,445 | 2,413 | 2,591 | 64,020 |
| 1954 | 9,070 | 481 | 2,549 | 3,757 | 13,511 | 16,926 | 3,268 | 25,976 | 2,298 | 3,127 | 3,523 | 84,486 |
| 1955 | 8,576 | 410 | 2,696 | 3,912 | 13,968 | 18,179 | 3,633 | 29,445 | 2,581 | 3,290 | 3,742 | 90,432 |
| 1956 | 7,555 | 357 | 3,011 | 3,877 | 14,520 | 19,787 | 3,503 | 32,989 | 2,817 | 3,519 | 4,076 | 96,011 |
| 1957 | 7,029 | 332 | 3,163 | 3,863 | 15,252 | 21,717 | 3,391 | 35,236 | 3,119 | 3,869 | 4,338 | 101,309 |

PERCENTAGE

| Year | U.S. Government securities | Foreign government bonds | State, provincial, and local bonds | Railroad bonds | Public utility bonds | Industrial and miscellaneous bonds | Stocks | Mortgages | Real estate | Policy loans | Miscellaneous assets | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1917 | 1.2 | 2.8 | 5.6 | 30.5 | 1.9 | 0.8 | 1.4 | 34.0 | 3.0 | 13.6 | 5.2 | 100 |
| 1920 | 11.3 | 2.3 | 4.8 | 24.3 | 1.7 | .7 | 1.0 | 33.4 | 2.3 | 11.7 | 6.5 | 100 |
| 1925 | 5.4 | 1.3 | 4.6 | 19.4 | 6.0 | .8 | .7 | 41.7 | 2.3 | 12.5 | 5.3 | 100 |
| 1930 | 1.7 | .9 | 5.4 | 15.5 | 8.6 | 1.9 | 2.8 | 40.2 | 2.9 | 14.9 | 5.2 | 100 |
| 1935 | 12.3 | .8 | 7.3 | 11.3 | 9.1 | 2.5 | 2.5 | 23.1 | 8.6 | 15.2 | 7.3 | 100 |
| 1940 | 18.7 | 1.0 | 7.8 | 9.2 | 13.9 | 5.0 | 2.0 | 19.4 | 6.7 | 10.0 | 6.3 | 100 |
| 1945 | 45.9 | 2.1 | 2.3 | 6.6 | 11.6 | 4.3 | 2.2 | 14.8 | 1.9 | 4.4 | 3.9 | 100 |
| 1950 | 21.0 | 1.7 | 2.4 | 5.0 | 16.5 | 14.9 | 3.3 | 25.1 | 2.2 | 3.8 | 4.1 | 100 |
| 1954 | 10.7 | .5 | 3.1 | 4.5 | 16.0 | 20.0 | 3.9 | 30.7 | 2.7 | 3.7 | 4.2 | 100 |
| 1955 | 9.5 | .4 | 3.0 | 4.3 | 15.5 | 20.1 | 4.0 | 32.6 | 2.9 | 3.6 | 4.1 | 100 |
| 1956 | 7.9 | .4 | 3.1 | 4.0 | 15.1 | 20.6 | 3.7 | 34.4 | 2.9 | 3.7 | 4.2 | 100 |
| 1957 | 6.9 | .3 | 3.1 | 3.8 | 15.1 | 21.5 | 3.3 | 34.8 | 3.1 | 3.8 | 4.3 | 100 |

Sources: Spectator Year Book and Institute of Life Insurance.

Mr. SAULNIER. I have no wish to cause you to digress from your intended remarks. I just want to point out that during the war period insurance company holdings of Federal debt increased sharply.

Senator O'MAHONEY. You will agree with me, I am sure, that insurance company holdings are just a small part of the question that I was trying to raise. So that is why I don't want to be diverted from that, particularly since I am advised we are operating under the 10-minute rule.

So I had better bring my question to a speedy end.

Let me continue to read. I was diverted by what Mr. Livingston had said.

This increase in interest rate—

he said—

makes them attractive for savings banks and insurance companies. This will make mortgage money expensive and scarce. It could force delays in plans for new office buildings, commercial buildings, and other projects, and it might deter State and local governments from financing public works. Government bonds now yield a percentage point more than blue chip industrial stocks. Investors and speculators are committed to continuing inflation and/or increased corporate profits and dividends, yet the rate of industrial expansion slowed in January. My feeling is that 1959 will be a flatter year than most Government economists expect, that Government revenues won't come up to Secretary Anderson's expectations, and that interest rates, financing, will become a major industrial problem some time during the year.

Fluttery Government bond markets such as we have been having are not conducive to confidence.

I cited that merely to show to you that there are business analysts with opinions which do not confirm your estimate that the receipts are going to increase. And I think it is of tremendous importance to Congress. I don't want to get into an argument with you. I am merely trying to find out what the facts are. I hope you are right, but I am afraid you are wrong.

Mr. SAULNIER. I certainly wouldn't want to say that there is unanimous agreement among business analysts on the business outlook. It would be a strange day, indeed, if that were so. I never expect to see the time when all business analysts will be in agreement on the economic outlook.

I have said that I think these estimates of revenues are reasonable ones. And I went beyond that and said that I thought they might very well be a bit on the conservative side.

Referring specifically to the interest rate questions which you have been talking about, I think we do have a problem there. When the yield on Government bonds rises, as it has, to a bit over 4 percent, this does raise a problem for the mortgage market, particularly because of the laws which place limits on the interest rate that can be charged for a Government-guaranteed mortgage.

As you know, Senator, there is a limit of 4¾ percent on GI loans. Now, as the rate on Government securities goes up, these securities become more attractive to investors than the GI loan. And you will observe that commitments for GI loans have, in fact, declined.

Let me say that I deplore this fact, and I wish that we could get some action from the Congress to prevent it.

Senator O'MAHONEY. What sort of action do you want from the Congress?

Mr. SAULNIER. Action that has been requested in specific language on a number of occasions. It would allow the maximum interest rate that can be charged on a federally underwriten mortgage to be set, within a reasonable range, by administrative action.

This would be a very constructive action for the Congress to take, and I urge it most strongly.

And may I say further that if it is not done, we may very well see a decline in the amount of money becoming available for investment in mortgages, which will not be good for our economy.

Senator O'MAHONEY. Well, then, do I understand you to say that a high interest rate does tend to hinder the borrowing of money by businesses and public bodies that desire to borrow for the purpose of expansion or construction, like the schools, for example?

Mr. SAULNIER. I think it does. I think there is no question about that, Senator.

But the problem to which I am addressing myself is, What happens when you have a fixed rate? This is a case of price fixing in the capital markets. And what I am asking for is a flexible price.

Senator O'MAHONEY. Yes, but to take the recommendation that has been made—Mr. Chairman, please stop me if I am taking too much time. When I get started asking questions, I don't know when to stop.

The CHAIRMAN. Congressman Curtis and Senator Williams have not had a chance to ask any questions.

Senator O'MAHONEY. Well then I will desist except to say, Mr. Saulnier, that when we last went over this matter with the Federal Reserve Board, we had testimony from public officials in the State of New York saying that the "high money rate was preventing the school districts of New York from borrowing money to build schools." They couldn't make the expansion of schools that they wanted to make. And so the demand has risen on Congress to provide Federal funds to do these things. And your recommendations for taxes on gasoline, on aviation gasoline, and on postal rates, are all of great importance.

I am sorry that I have taken so much time.

The CHAIRMAN. Congressman Curtis.

Representative CURTIS. Dr. Saulnier, on this unemployment figure, which, of course, is so important in evaluating some of these trends, certainly from the standpoint of public relations, there is one thing I have been disturbed about, and I know most people have. I don't know how to term it. But it is the seemingly high level of unemployment that seems to have existed since right after the Korean war. When we came out of the recovery after the 1954 recession it seems that unemployment came out on a relatively higher base than before. There seems to be some question now whether even after this recovery we will not again come out at a higher level.

I am wondering whether or not this lies in our methods of taking economic statistics or whether it might be explained by an increased number of seasonally employed people who report that they are looking for work, and yet their work habits indicate that they are seasonal, or perhaps we have more retired people in our society who, if asked, would say they are looking for work and yet in essence they are retired. Have you any comments?

What speculations have you made as to what might lie behind this increased base of unemployment?

Mr. SAULNIER. I have observed that. It is true that the unemployment ratio was a bit higher when this last recession began than it had been in 1953.

And accordingly, although the increase during the recession was no greater than the increase during the 1953–54 recession, it brought us to a substantially higher level. This does raise questions as to the composition of the unemployed. More properly, it raises questions as to the composition of the labor force, and whether in this period there have been accretions to the labor force of people who are perhaps less dependent upon jobs than others.

That is a possibility, but I can't say that I have any knowledgeable speculations to make on it today. I would be glad to have this analyzed more fully if that would be useful to you. It would be useful to me, and I would like to do it in any case.

Representative CURTIS. I would appreciate it if you would. Of course, one of the statistics that we haven't paid too much attention to but which I, in trying to evaluate, might be revealing. It is the percentage of work force in relation to the population 14 years of age and over. I think those figures run around 58 percent. I am wondering whether or not there might be some revelations in there.

And then one other point: I notice in your table D–18 on page 160, which breaks down the employed by age groups and by male and female, that it is interesting to know that the male between 20 and 44 years, it has been a rather constant employment since 1947 of about 23 million, with some fluctuation, while the increase in numbers employed seems to be mainly females and people 45 years and over.

I am interested from the social security angle too, because I serve on the Social Security Subcommittee. We lowered the retirement rate of course in social security, and I am curious to know if that had an impact upon our employment figures.

Mr. SAULNIER. It might have.

Representative CURTIS. I wonder if it might not be well to have another breakdown in those statistics to show 60 and over, possibly. Are there such?

Mr. SAULNIER. I cannot say that there are such figures in existence now, but I will certainly look into it. I agree with you that it would be a useful figure to have.

Representative CURTIS. Yes.

Then one other line of questioning, Mr. Chairman.

In the Economic Report, on page 3, you point out that the recession had been preceded by a major expansion in productive capacity without a corresponding increase in utilization.

And then of course you point out on the same page:

> Business expenditures for new plant and equipment which had fallen only 11 percent in the previous recession dropped 22 percent here.

Then on page 10 at the bottom you say:

> Major developments were the decrease in the volume of incoming business of the capital-goods industry and reduced appropriations by manufacturing businesses for their investment expenditure programs and lower expenditure for machinery, equipment, and new facilities. And corporate liquidity was low in the instance of capital issues being postponed because of unfavorable financing increased. Clearly financial considerations were exerting a progressively greater influence on businesses to restrict their commitments for further expansions of their facilities.

I agree with that, but there seems to be an apparent paradox or inconsistency in the statement that the large expansion in productivity capacity without full utilization, the reason for the cutback in further business expansion rather than financing. I personally think that both occurred. But I think the difference lies in certain areas. There was this expansion. But not in other areas.

And one area I would suggest that we did not have expansion in, was in the distributive industries and services. And that was the same area in which we saw this strange situation of price increases coming along during the recession. And it was inasmuch as the distributive industries are largely composed—I think it is around 80 percent—of all businesses, and it was the small business sector that was primarily hit on this business of being able to finance its growth and expansion.

I am wondering whether a further analysis of these two factors which seem inconsistent without explanation might be revealing?

Mr. SAULNIER. Quite possibly so. But let me say that the reference to the increase in capacity outrunning the increase in production was a reference to manufacturing.

Representative CURTIS. Yes. Durables primarily.

Mr. SAULNIER. It is true that in 1956 and 1957 there was a growing disparity between capacity on the one hand and production on the other hand in manufacturing. And the disparity was far greater in some lines of manufacturing than in others.

At the same time, and particularly toward the end of 1957—it came to a peak about August of 1957—we had considerable tightness in the credit and capital markets. This was an additional factor tending to restrain financing by companies that desired additional funds.

So that in effect there were two factors operating: A very basic factor in the tendency for capacity to outrun production and also a restraint being exercised via the capital markets. And I would say that in terms of the stability of our economy and the balance of economic growth, that restraint was a good thing.

Representative CURTIS. Well, now, McGraw-Hill makes estimates of prospective business expenditures for plant expansion.

Mr. SAULNIER. That is correct.

Representative CURTIS. In interrogating one of their people, they agreed that their estimates were entirely based on large companies and that they were largely in the manufacturing sector. I was interested to know that their estimates on that weren't too far off in this recession. There was a continued expansion, but we knew it was tapering off.

But—and this is a subject I have observed and is more dangerous—I know a great many small businesses—I am talking now about good growth ones, not necessarily the tiny ones, now, but substantial small businesses—they were planning on further expansion; they depend upon retained earnings largely to finance their expansion. They are not capable of floating new stock issues. They are the ones that seemed to me that really cut back.

And they are the ones that wanted to expand because they had not exceeded their productive capacity. Quite the contrary. There were demands for their capacity. To possibly oversimplify it but to illustrate the point: A television repair shop could use a lot more TV repair technicians. And one reason the cost of repairing TV's for household operators is what it is, is because of the shortage in that area. And in other service areas like that, I think our common experience shows that there is a shortage, such as plumbers and a lot of other technicians of that kind.

Mr. SAULNIER. That may well be true. On the other hand, the decline in capital expenditures to which we alluded in the Economic Report, and which was such an important factor in the recession, was primarily a decline of expenditures by larger companies.

Representative CURTIS. Well, this is a big area, though. You take the distributive industry, if my figure is right—I think it is about right—and I wish I knew what the real figure was—surely it is somewhere—but about 80 percent of the volume industry in distribution is done by what we would call smaller concerns and not big concerns.

Mr. SAULNIER. Those figures would show up in commercial construction.

Yet, commercial construction held up pretty well in the recession.

Representative CURTIS. Well, that is true.

Mr. SAULNIER. By and large.

Representative CURTIS. Although these smaller concerns——

Mr. SAULNIER. Excuse me. Industrial construction, on the other hand, fell off quite sharply which would reflect the impact of recession on the manufacturing concerns.

Representative CURTIS. Yes. Well, my time is up. So I will just make two points.

But the point is that in this area of the distribution, the distributive industries, and the service industries, assets and growth are not measured in depreciable items; it is measured more in inventory and in accounts receivable. That is where they have to expand their capital. So you wouldn't catch it in construction.

Mr. SAULNIER. Not at all, that is right.

Representative CURTIS. That is why I wonder about this. And I am suspicious that this was a tremendous factor in this last recession; so much so that I almost believe that a great deal of it could come in your second statement on page—whatever it was—that it was unfavorable financial conditions that cut back on the economic growth more than it was—more than this other factor that there was an overexpansion in certain areas.

The CHAIRMAN. Senator Williams.

Senator WILLIAMS. Mr. Chairman, I appreciate the opportunity to be here as an observer. We haven't officially set up our membership. And I don't know whether I or who will be the member. I would ask just a couple of questions in connection with Congressman Curtis' questions here on this industrial construction cutback in 1957.

Do you think that was attributed primarily to interest rates and the cost of interest? Or do you think that the fact that—I think that was about the same time that Congress eliminated the so-called rapid depreciation of 5-year amortization certificates—do you not think that that had something to do with it?

Mr. SAULNIER. Yes, I think that the accelerated amortization certificates had a good deal to do with the rapid incrase——

Senator WILLIAMS. In 1956–57.

Mr. SAULNIER. They were granted, of course, in connection with facilities for which there was a national security need.

And as that need was met, fewer of those certificates were granted.

This was a stimulating factor. And there is a moral to be drawn from this, namely, that a stimulus can be given to investment and to economic growth by a liberalization of depreciation regulations.

Senator WILLIAMS. My question was "Do you not think that the rate of depreciation which was allowed had as much effect upon the plans of these companies as did the interest rates?"

Mr. SAULNIER. Well, of course, the interest rate factor worked more broadly. I would hesitate to assign primacy to one or the other, as a factor. I really wouldn't know how to do it.

While I feel that the interest rate was a factor, I do also feel that there was a tendency during this period to get just a bit ahead of ourselves in terms of capacity relative to production.

Senator WILLIAMS. Do you think that a part of the depth of the recession last year resulted from overexpansion in prior years which was encouraged by Congress perhaps carrying this 5-year amortization period a little too long?

Mr. SAULNIER. A number of factors associated with our national security programs had an influence in promoting expansion in 1955, 1956, and, to a lesser degree, in 1957. There was stockpiling. Let us remember that the U.S. Government was going into the market and buying hundreds of millions of dollars worth of all kinds of materials in 1954, in 1955, and in 1956.

Now, we find ourselves in most of these cases with perfectly ample stocks. Indeed, for many materials our stocks are far more than any reasonable judgment of what is necessary for security purposes. Accelerated amortization was another factor. But these things have tended to diminish.

Senator WILLIAMS. Do you think one of the justifications for higher interest is that it could be used as a check for inflation?

Mr. SAULNIER. No question about that.

Senator WILLIAMS. You think it is?

Mr. SAULNIER. No question about that, sir. The interest rate is, after all, a market price determined by the interplay of the demand for credit and capital on the one hand and its supply on the other hand. During an expansion period that demand increases sharply—tends to outrun the supply of savings; and the interest rate will reflect that fact.

Senator WILLIAMS. Do you think from the standpoint of the Government's program to check inflation it would be better to get a larger percentage of our debt in the hands of the public than in the banks?

Mr. SAULNIER. It would be a substantial advantage to have a larger proportion in the hands of the public. That would mean, Senator, that a smaller part of the debt would come due year in and year out; and it would make the management of our very large public debt a simpler operation. What is particularly important, it would make debt management operations interfere less with monetary policy.

Senator WILLIAMS. I am in agreement with that reasoning but I am wondering how we can reconcile that with the fact that that proportion of our debt which is more or less offered to the public, the series E bonds, are offered to the public at a lower interest rate than is being offered at the banks today.

Is that not the cheapest form of borrowing that we are insisting upon right at this time?

Mr. SAULNIER. We must include, of course, in the debt that is offered to the public not just the series E bonds and the other savings bonds, but all of the longer term issues——

Senator WILLIAMS. I agree with you.

Mr. SAULNIER (continuing). That go to insurance companies to which Senator O'Mahoney was referring, and to savings banks and so on.

Senator WILLIAMS. I agree with you.

Mr. SAULNIER. And they carry rates which, as has been pointed out, one attempts to put at the market.

Senator WILLIAMS. I agree with you to a point. But series E, we put emphasis upon the fact that they are the workingman's bonds. And this workingman's bond is the lowest interest rate bond that we have on the market today.

Is that not true? For the period of time in which it is supposed to run, that is?

Mr. SAULNIER. The yield to maturity would be below the yield——

Senator Williams. On the 4 percent that was sold the other day.

Mr. Saulnier. That is correct.

Senator Williams. Is that not a contradictory program?

Mr. Saulnier. I expect that if there were a higher rate at this time on the series E bond, you might get larger sales of them. But remember, Senator, that these bonds have a feature which the other bonds do not have. That is, they have a fixed value in dollars for the holder of the bond at any time during its life.

On the other hand, the fellow who buys the free market bond has to take his chances on price. And some of them, I believe, got a short course of instruction on this matter during the last summer.

Senator Williams. That is true. But when we first developed the plans for the E bonds, they were offered on the basis that they would be a higher yielding bond to the wage earner, with a limitation on the amount he could hold.

We have reversed that policy recently; is that not true?

Mr. Saulnier. Well, let us say events have reversed it.

Senator Williams. That is right.

The Chairman. Mr. Saulnier, Congressman Reuss expressed his concern earlier about the continuing high volume of unemployment, which is a concern which I also share. But I would like to address your attention and the attention of the group, if I may, to what seems to many of us to be an inadequate rate of growth in economy in recent years. And as a basis for discussion, I would like to bring forward the indexes of industrial production in the figures on gross national product and capital. On page 16 of the Economic Indicators, the index of industrial production composed of manufacturing and minerals is given showing an index of 134 for 1953; and an index of 142 for December 1958. Or an increase of 8 points and 6 percent during the 5 years.

On page 155 of the report, the population figures are given for this period: 159.6 million in 1953, an average of 174.1 million in 1958. There is a higher figure at the end of the year. But I will take simply the year totals. That is an increase of 14.5 million, or an increase of 9 percent in population as compared to an increase of 6 percent in physical production, indicating an actual decrease in physical production in manufacturing and minerals.

Mr. Saulnier. Per baby?

The Chairman. No; per capita. Now, in addition to that, I have asked the staff to prepare figures on gross national product per capita in 1958 dollars. And they have submitted the following table which we believe to be approximately accurate, although it may be that a figure here and there at the end is not correct to the final dollar.

(The table referred to follows:)

*Gross national product per capita in 1958 prices, 1946–58*

[In dollars, 1958 prices]

| Year: | GNP per capita | Year—Continued | GNP per capita | Year—Continued | GNP per capita |
|---|---|---|---|---|---|
| 1946 | 2,208 | 1951 | 2,459 | 1956 | 2,652 |
| 1947 | 2,164 | 1952 | 2,505 | 1957 | 2,635 |
| 1948 | 2,208 | 1953 | 2,576 | 1958 | 2,508 |
| 1949 | 2,172 | 1954 | 2,483 | | |
| 1950 | 2,318 | 1955 | 2,634 | | |

Source: U.S. Department of Commerce.

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The CHAIRMAN. 1946 gross national product per capita in 1958 dollars, $2,208; 1948, $2,208, no increase in that period; 1950, $2,318; 1952, $2,505. Or an increase in those 4 years or 6 years of almost precisely $300 per capita or something like 13 percent.

On the other hand if we take the terminal figure of 1958, we have a figure of $2,508. Or just approximately the same as in 1952, or of no growth in 1958 as compared to 1952. And if you were to go back to 1957 the increase there over 1952 would be $130 or about 5 percent, indicating a slowing up of the rate of growth.

Now granting the stability of the price level is important, it also seems to me that the rate of growth is important. And I am concerned about the slowing down of the rate of growth. And I wonder if you are concerned about it?

Mr. SAULNIER. I would indeed, be concerned about it.

The CHAIRMAN. Are you concerned about it or would you be concerned about it?

Mr. SAULNIER. I would like to see a higher rate of growth, consistent with the other objectives which I think we have to take account of.

The CHAIRMAN. Do you have any suggestions for raising the rate of growth?

Mr. SAULNIER. We have put forward, Senator, in the Economic Report a program to promote economic growth and price stability. And I believe, sir, that it would.

The CHAIRMAN. What are the specific features in this program that you say can combine these objectives?

Mr. SAULNIER. The specific features are, first, the financial plan which had been put forward by the administration for the fiscal year 1960. As you know, this plan contemplates a balance of expenditures and receipts.

If that plan is adhered to we can look forward to some reform of our tax structure, and some reduction in our taxes. I would expect this to be a powerful factor making for economic growth.

Furthermore, adherence to this financial plan would have a stimulating effect through our economy at the psychological level.

Other proposals have also been made, but by and large our growth can be promoted by Government at this time through the proper management of our financial affairs.

We are in a good recovery right now, and I expect under appropriate policies that recovery can be carried forward through 1959. And in my judgment, 1960 can be a substantially better year than 1959.

The CHAIRMAN. Mr. Saulnier, do I understand that the first feature of economic growth, the first necessary feature of economic growth, you regard as price stability?

Mr. SAULNIER. I don't understand your question, Senator.

The CHAIRMAN. On page 67 of the Economic Report you say:

Measures to promote economic growth with price stability. (A) Amends the Employment Act of 1946 to make price stability an explicit goal of Federal economic policy.

The CHAIRMAN. Since that is listed first, I assume that you regard that as the most important element of economic growth.

Mr. SAULNIER. Well, I think that would be an entirely inadmissible assumption, Senator.

The CHAIRMAN. I thought you had been emphasizing price stability as necessary for economic growth or was it a balanced budget that you emphasized as necessary for economic growth?

Mr. SAULNIER. In my judgment, at this time a balanced budget would be a powerful factor aiding economic growth.

The CHAIRMAN. You have an item "I" on page 67. "Enact a long-range program to conserve helium gas."

I wonder if you regard this as of major importance?

Mr. SAULNIER. No, sir.

The CHAIRMAN. I was somewhat struck with that recommendation as a measure to promote growth.

Mr. SAULNIER. It happens to be a matter of some consequence in the newer metallurgical processes. And I would not disparage it as an important thing for the Congress to do. On the other hand, Senator, our growth will not rest on the action of the Congress with respect to helium gas.

The CHAIRMAN. I am delighted to learn that. I thought that was probably too gaseous. And you would not have a condensation of the gases to create heavenly bodies.

Mr. SAULNIER. Not at all.

The CHAIRMAN. I am a little disappointed, Mr. Saulnier, I must confess, on your treatment of this subject of growth. I believe in price stability. I think the central problem of our times, however, is how to combine price stability and growth.

Mr. SAULNIER. I agree.

The CHAIRMAN. And certainly it is true, I believe, that our rate of growth in the last 6 years has been unsatisfactory, unsatisfactory in terms of our past, and from tables which our staff have prepared and which I will now ask to have inserted in the record, unsatisfactory as compared to other countries in the Western Alliance. I am not speaking of Soviet Russia at the moment at all. This is a table which the staff has drawn from the OEEC showing the growth rates of the United States in 1953–57 of seven-tenths, 0.7 of 1 percent as contrasted with the growth rate in France of 4.7 percent; West Germany of 6.4 percent; Italy 4.9 percent; Netherlands 4.2 percent; Sweden 3.5 percent; Switzerland 4.8 percent; and even of the United Kingdom, which has been going forward very slowly, of 2.2 percent.

(See also p. 284.)

(The material referred to follows: )

## Economic Growth Comparisons, OEEC Countries and the United States

### Table 1.—*Rates of growth of real gross national product, 1948–57*

[Percent]

| Country | 1948–50 | 1950–53 | 1948–57 | 1948–57 |
|---|---|---|---|---|
| OEEC member countries (total) | 7.7 | 4.2 | 4.7 | 5.2 |
| Selected countries: | | | | |
| France | 10.9 | 3.8 | 5.5 | 6.0 |
| Germany (Federal Republic) | (1) | 8.7 | 7.5 | [2] 8.0 |
| Italy | 6.2 | 6.0 | 5.4 | 5.8 |
| Netherlands | 6.7 | 3.8 | [3] 5.3 | [4] 4.9 |
| Sweden | 6.1 | 2.1 | [3] 3.9 | [4] 3.8 |
| Switzerland | .2 | 4.7 | [3] 5.8 | [4] 4.0 |
| United Kingdom | 3.3 | 2.2 | 2.7 | 2.7 |
| United States | 4.2 | 5.1 | 2.5 | 3.7 |

[1] Not available.
[2] 1950–57.
[3] 1953–56.
[4] 1948–56.

See footnote *, p. 28.

Source: Organization for European Economic Cooperation.

### Table 1A.—*Rates of growth of per capita real gross national product, 1948–57*

[Percent]

| Country | 1948–50 | 1950–53 | 1953–57 | 1948–57 |
|---|---|---|---|---|
| OEEC member countries (total) | 6.7 | 3.2 | 3.8 | 4.7 |
| Selected countries: | | | | |
| France | 9.6 | 2.1 | 4.7 | 4.9 |
| Germany (Federal Republic) | (1) | 7.7 | 6.4 | [2] 6.9 |
| Italy | 5.7 | 5.2 | 4.9 | 5.1 |
| Netherlands | 5.2 | 2.1 | [3] 4.2 | [4] 3.6 |
| Sweden | 5.0 | 1.4 | [3] 3.5 | [4] 3.0 |
| Switzerland | −1.1 | 3.6 | [3] 4.8 | [4] 2.8 |
| United Kingdom | 2.8 | 2.1 | 2.2 | 2.3 |
| United States | 2.9 | 3.2 | .7 | 2.0 |

[1] Not available.
[2] 1950–57.
[3] 1953–56.
[4] 1948–56.

See footnote *, p. 28.

Source: Organization for European Cooperation.

### Table 2.—*Rates of growth of industrial production, 1948–57*

[Percent]

| Country | 1948–50 | 1950–53 | 1953–57 | 1948–57 |
|---|---|---|---|---|
| OEEC member countries (total) | 11.6 | 3.8 | 7.0 | 7.4 |
| Selected countries: | | | | |
| France | 5.5 | 4.0 | 8.7 | 6.4 |
| Germany (Federal Republic) | 27.9 | 11.5 | 10.1 | 14.4 |
| Italy | 12.1 | 8.6 | 8.3 | 9.2 |
| Netherlands | 11.4 | 4.4 | 5.9 | 6.6 |
| Sweden | 3.9 | 1.7 | 5.9 | 3.4 |
| Switzerland | −4.5 | 2.0 | 2.5 | .7 |
| United Kingdom | 7.1 | 2.1 | 3.8 | 3.9 |
| United States | 3.8 | 6.2 | 1.6 | 3.6 |

Source: Organization for European Economic Cooperation.

See footnote *, p. 28.

TABLE 3.—*Rates of growth of real gross domestic fixed capital formation, 1948–57*

[Percent]

| Country | 1948-50 | 1950-53 | 1953-57 | 1948-57 |
|---|---|---|---|---|
| OEEC member countries (total) | 11.1 | 5.0 | 7.8 | 7.4 |
| Selected countries: | | | | |
| France | 5.4 | 1.3 | 9.5 | 5.8 |
| Germany (Federal Republic) | (1) | 8.5 | 9.7 | [2] 9.2 |
| Italy | 5.3 | 9.4 | 8.6 | 8.1 |
| Netherlands | 9.9 | 1.6 | [3] 12.7 | [4] 8.0 |
| Sweden | 4.2 | 4.2 | [3] 3.9 | [4] 4.1 |
| Switzerland | (1) | (1) | (1) | (1) |
| United Kingdom | 6.9 | 4.0 | 5.9 | 5.4 |
| United States | 5.7 | 1.5 | 3.6 | 3.4 |

[1] Not available.
[2] 1950–57.
[3] 1953–56.
[4] 1948–56.

See footnote *, p. 28.

Source: Organization for European Economic Cooperation.

TABLE 4.—*Rates of growth of real private consumption, 1948–57*

[Percent]

| Country | 1948-50 | 1950-53 | 1953-57 | 1948-57 |
|---|---|---|---|---|
| OEEC member countries (total) | 5.2 | 3.7 | 4.4 | 4.3 |
| Member countries: | | | | |
| France | 6.8 | 5.5 | 5.3 | 5.7 |
| Germany (Federal Republic) | (1) | 8.7 | 7.5 | [2] 8.0 |
| Italy | 6.2 | 5.6 | 3.6 | 4.8 |
| Netherlands | —.5 | .7 | [3] 7.2 | [4] 2.8 |
| Sweden | 2.7 | 1.4 | [3] 3.3 | [4] 2.4 |
| Switzerland | (1) | (1) | (1) | (1) |
| United Kingdom | 2.2 | 1.1 | 2.4 | 1.8 |
| United States | 4.5 | 2.3 | 3.5 | 3.5 |

[1] Not available.
[2] 1950–57.
[3] 1953–56.
[4] 1948–56.

See footnote *, p. 28.

Source: Organization for European Economic Cooperation.

TABLE 5.—*Rates of increase of consumer prices, 1948–57*

[Percent]

| Country | 1948-50 | 1950-53 | 1953-57 | 1948-57 |
|---|---|---|---|---|
| OEEC member countries: | | | | |
| France | [1] 11.2 | 8.9 | 1.1 | [2] 5.3 |
| Germany (Federal Republic) | −3.4 | 2.4 | 1.7 | .8 |
| Italy | .1 | 5.2 | 3.1 | 3.1 |
| Netherlands | [1] 8.6 | 4.3 | 4.7 | [2] 5.0 |
| Sweden | 1.3 | 8.1 | 3.3 | 4.5 |
| Switzerland | −1.1 | 1.6 | 1.3 | 1.0 |
| United Kingdom | 2.6 | 7.2 | 3.8 | 4.7 |
| United States | 0 | 3.6 | 1.3 | 1.8 |

[1] 1949–50.
[2] 1949–57.

See footnote *, p. 28.

Source: Organization for European Economic Cooperation.

TABLE 6.—*Annual average rates of unemployment, 1948–57**

[Percent]

| Country | 1948–50 | 1951–53 | 1954–57 | 1948–57 |
|---|---|---|---|---|
| OEEC member countries: Selected countries: | | | | |
| France [1] | 1.6 | 1.8 | 1.6 | 1.7 |
| Germany [2] | 7.8 | 8.2 | 4.8 | 6.6 |
| Italy | (3) | (3) | (3) | (3) |
| Netherlands [4] | 5.2 | 9.2 | 4.5 | 6.1 |
| Sweden [5] | 2.6 | 2.3 | 2.7 | 2.6 |
| Switzerland | (3) | (3) | (3) | (3) |
| United Kingdom [6] | 1.6 | 1.5 | 1.3 | 1.5 |
| United States [7] | 5.0 | 3.1 | 4.6 | 4.3 |

[1] Applicants for work as percent of nonagricultural employment plus applicants for work.
[2] Registered unemployment as percent of total employees plus registered unemployed.
[3] Not available.
[4] Registered unemployment as percent of total employment in industry plus registered unemployment.
[5] Unemployed members of trade unions as percent of all members.
[6] Wholly unemployed as percent of estimated number of insured employees.
[7] Unemployed as percent of civilian labor force.

Source: Organization for European Economic Cooperation and U.S. Department of Commerce.

TABLE 7.—*Real gross domestic fixed capital formation as a percent of real gross national product, 1948–57**

| Country | 1948–50 | 1951–53 | 1954–57 | 1948–57 |
|---|---|---|---|---|
| OEEC member countries | 16.1 | 16.4 | 18.4 | 17.2 |
| Selected countries: | | | | |
| France | 17.5 | 15.9 | 17.2 | 16.9 |
| Germany (Fed. Rep.) | (3) | 18.9 | 21.8 | 20.7 |
| Italy | 17.3 | 18.6 | 20.7 | 19.2 |
| Netherlands | 19.6 | 19.7 | [1] 22.8 | [2] 20.9 |
| Sweden | 18.3 | 18.6 | [1] 19.9 | [2] 19.0 |
| Switzerland | (3) | (3) | (3) | (3) |
| United Kingdom | 12.5 | 12.9 | 14.6 | 13.5 |
| United States | 25.0 | 25.2 | 25.4 | 25.2 |

[1] 1954–56.
[2] 1948–56.
[3] Not available.

Source: Organization for European Economic Cooperation.

*The above tables provide the basic information necessary for obtaining indicators of the development, in terms of both volume and prices of the national product and expenditure of member countries combined. In using them the limitations to which the data are subject should be borne in mind. First, there are a number of gaps in the original country statistics from which these OEEC totals were derived, especially for the earlier years of the period. These gaps had to be filled in by the OEEC Secretariat with estimates which in many cases may be subject to an important margin of error. The estimates for change in stocks in 1938, 1947, and 1948 are particularly uncertain and should be regarded only as rough indicators of the probable order of magnitude. Secondly, the official exchange rates used to convert European currencies to dollars considerably understate the relative purchasing power of these currencies, and consequently distort seriously the comparison of the levels of real national product and expenditure in Europe with those in the United States. The inadequacies of conversion by exchange rates are much less important, however, for the development over time of the volume and price indices implied in the data, since the choice of the conversion factor here only influences the relative weights assigned to the individual countries in arriving at the average for the OEEC member countries.

For a fuller discussion of the significance and limitations of the data presented in these tables, see "Statistics of National Product and Expenditure, No. 2, 1938 and 1947–55," pp. 33–35.

Source: Excerpt from p. 99, OEEC "Statistical Bulletin No. 4," July 1958.

The CHAIRMAN. It seems in comparison with our past and in comparison with our allies that we have not been going forward as rapidly as we should. This, it seems, is a central problem.

Mr. SAULNIER. May I comment on that, Senator?

The CHAIRMAN. Certainly.

Mr. SAULNIER. First of all, the comparison of growth here with growth in Western Europe must recognize that in Western Europe we have had recovery from a war. It is natural that under such circumstances there would be a rather high rate of growth in contrast to growth in the United States, where we are not making up for war damage.

This is not to say, Senator, that I don't welcome the fact that economic growth in France and in Western Germany and in Britain has been at a high rate.

The CHAIRMAN. Of course, we all welcome that. But I would like to point out that these 1953–57 figures start 8 years after the war rebuilding finished; so that a very considerable degree of the war damages was already affected. So that you are not starting from a devastated continent. Quite the contrary, you are starting with a continent that was pretty far along in 1953.

Mr. SAULNIER. Of course, Western Europe has been undergoing a great revival in these recent years.

But let me point out some figures on economic growth that are also interesting.

The CHAIRMAN. Do you deny the accuracy of the figures which I have submitted?

Mr. SAULNIER. No, only the interpretation that one might place upon them.

Mind you, I don't pose as an expert on OEEC figures. But I know enough about GNP figures to be very skeptical of them. Our own included.

Yet I have no doubt but what they are broadly accurate.

Now on this matter of economic growth in the United States: It is true that if you make the growth in gross national product in recent years the basis of comparison you will find that we have been growing at a slower rate than in the immediately preceding period.

For example, if you take the years 1952–57, our average rate of growth of real GNP was 2.8 percent.

And if you take the years 1947–52, you will find that the rate was a good bit higher. It was 4.7 percent, according to my calculations; 4.7 percent is the average annual rate of increase which, if compounded, would bring you from the 1947 figure to the 1952 figure.

Now, that is the common and most usual basis for the measurement of growth.

Now, suppose you ask how has our civilian economy has grown?

The CHAIRMAN. Pardon me. Were your figures total figures or per capita figures?

Mr. SAULNIER. Total figures.

Yes, my reference to babies earlier, Senator, was pursuant to call attention to the fact that we have had quite a baby boom of late. And you have to take account of this in calculating per capita figures.

Also the increasing number of older people.

Now, if you take just that piece of national product which is directed to consumption by individuals; namely, personal consumption expenditures, and add residential housing, what do we find?

Let me interpolate by saying that, as I understand an economy, its ultimate purpose is to produce more consumer goods. This is the goal. This is the object of everything that we are working at: to produce things for consumers.

Senator O'MAHONEY. But we must have consumers who can buy.

Mr. SAULNIER. Well, let's look at the record, Senator.

From 1947 to 1952 the annual rate of increase of the consumption sector of our economy was 2.9 percent.

From 1952 to 1957, it was 3.8 percent.

Now this is an interesting and important difference. In other words, if you take total GNP, you find that growth in recent years has lagged. But if you look at consumption—the thing which, as I say, I regard myself as being commissioned to maximize—you find that we are doing better.

Let's make another interesting comparison. You may ask how our economy is behaving as regards the production of things which will make it possible to produce more consumer goods in the future; namely, business plant and equipment expenditures.

These are very simple figures. I don't want to make too much out of them. But I think they are suggestive.

The CHAIRMAN. What page is this found on?

Mr. SAULNIER. They are calculations that can be made from any GNP figure. I am using GNP in 1958 prices.

Now, if you take business fixed investment—that is, fixed investment expenditures, excluding residential construction—the annual rate of increase from 1947 to 1952 is 1.8 percent. Not a very high rate.

On the other hand, the average rate of increase between 1952 and 1957 was 3.2 percent. Now, let's just go one step further and examine economic growth in terms of the aggregate of consumptive goods, business fixed investment, and nondefense governmental expenditures. How do we compare on this basis? This is what you might call the peacetime economy. Between 1947 and 1952, its average rate of growth was 3 percent. Not a bad rate. But between 1952 and 1957, it was 3.7 percent.

The CHAIRMAN. And 1958 is a recession year.

Mr. SAULNIER. And let me point out, sir, that we are already back to the 1957 rate and headed up.

And I expect that in 1959 and in 1960 we will continue to grow at good rates.

All in all, I think it is a rather good record. In fact, a very good record.

The CHAIRMAN. My time is up, Mr. Saulnier. I don't want to shut you off. But I think some of the others have questions.

Senator O'MAHONEY. I think I ought to congratulate you, Mr. Saulnier, on some of the recommendations:

> The Congress is urged to act favorably on five proposals as follows—

I am not sure that I agree with all of them, but with some of them I do—

> To authorize Federal regulation of the merger of banking institutions, accomplished throughout the acquisition of assets.

I think that is a very good recommendation.

> The merger of the big banks and the big companies in this country which has been a marked characteristic of recent years is adverse, in my judgment, to the development of new enterprise and competitive enterprise.

And I am happy to see this general recommendation in your recommendations.

Mr. SAULNIER. This would put on an equality of treatment mergers effected through acquisition of assets and those effected through acquisition of stock.

Senator O'MAHONEY. Then the next recommendation as I see it here:

To require notification to the antitrust agencies when firms of significant size that are engaged in interstate commerce propose to merge.

Well I have already introduced a bill to do that, Mr. Saulnier. So naturally I feel pleasant about this recommendation in here.

To grant the Attorney General power to issue civil investigative demands under which the necessary facts may be elicited when civil procedures are contemplated in antitrust cases.

That is a new one to me. And I think I can assure you that the Judiciary Committees of both Houses will be interested in going into that.

Mr. SAULNIER. May I say with reference to that, Senator, that it is not a new proposal. I think it is a good one. It would make it possible where no criminal proceedings are contemplated to avoid going through a grand jury proceeding in order to obtain the kind of information that is necessary to pursue a civil action.

Senator O'MAHONEY. Well, I strongly advocate that sort of procedure. I have long been of the opinion that punitive policies are not desirable because they create distrust between Government and industry. And the more cooperation we can get and the more procedure we can get on the civil side, the better it will be.

I have introduced a bill which I hope you will have an opportunity to examine. I think it is S. 215, to require certain corporations in which more than 50 percent of individual commodities are produced by less than 8 corporations to file with the Government a 30-day notice of intent to raise prices.

I think by throwing the floodlight of public examination on the reasons for a price increase, we might deter those increases. And since we are both interested in fighting inflation and price stability I will send you a copy of that bill.

In addition to that you say—

to make cease and desist orders issued by the Federal Trade Commission for violations of the Clayton Act final unless it be in the courts.

I applaud that.

Senator Sparkman, a member of this committee, and chairman of the Small Business Committee, has introduced that bill again, or is about to. And I am cosponsor of it.

Then the fifth:

To authorize the Federal Trade Commission to seek preliminary injunctions in merger cases where a violation of law is likely.

I think that could be broadened to go beyond the cases where a violation of law is likely. I think that there are economic reasons which should prevent mergers.

Mr. SAULNIER. Apart from a violation of the law.

Senator O'MAHONEY. Yes; apart from a violation of the law.

But the suggestion is one of preventative action. And I feel very much satisfied that you are proceeding along that line. But some of these other suggestions that I find here raise questions.

You say on page 49:

The expenditures estimated for fiscal 1950 are 3.9 billion less than those estimated for the present fiscal year. A few items account for most of the differ-

**ence. First an important part is accounted for by a nonrecurring expenditure of about 1.4 billion for the increased quota of the United States in the international monetary fund which is recommendde for the fiscal year 1959.**

Now, the budget discloses that although Congress last year authorized $625 million for the development loan fund, it appropriated only $400 million.

Under Secretary of State Dillon in a speech made on the Pacific coast earlier in the year—that is, in 1958—urged that that amount should be raised to $1 billion.

The President's budget didn't go that far. But it includes the recommendation of $225 million for fiscal 1959 and $700 million for fiscal 1960, making a total of $925 million for the development loan fund.

To my mind, one of the undesirable aspects of that development loan fund program is that no reports are made on the projects which are undertaken until the end of the year in the President's report. When Congress authorized the development loan fund first, it required a report on each transaction. The State Department persuaded the Foreign Relations Committees to temporize that by providing that the report should not be made until after the commitment was made.

I am strong in the belief that the report should be made before the commitment is made.

But in any event, the President's budget now calls for $700 million for the next year. And the International Cooperative Administration tells me that there are a tremendous number of applications. But Congress knows nothing about them. And what strikes me about it all is that some of these are for the development of natural resources in other countries, while the program holds back the development of natural resources in the United States.

My feeling is that in the present situation in this country our economic policy ought to be designed to promote new income in the United States.

What is your feeling about that?

Mr. SAULNIER. Well, let me point out that the budgeted expenditures for natural resources for the fiscal year 1960 are $1,710 million.

Senator O'MAHONEY. That is correct; 2.2 percent of the total outlay, as compared with 10.5 percent for interest on the national debt.

Mr. SAULNIER. Furthermore, this high level of expenditures is sustained in 1959 and 1960. And it is substantially above earlier rates of spending on national resource development.

Senator O'MAHONEY. What I am pointing out to you, sir, is that the President's budget specifically declares that no new starts are to be made in 1960. Now, that is a declaration, it seems, of abandoning the development of our natural resources.

Mr. SAULNIER. I wouldn't say it is that at all, sir. The budget specifically provides for increased expenditures. Let us take water resources, and let me refer you to page 973 of the budget.

I am talking here, Senator, about the actual expenditures of the U.S. Government.

Senator O'MAHONEY. I am talking about the program for the future.

Mr. SAULNIER. These actual expenditures measure our activity year in and year out.

In the year 1958, fiscal 1958, those expenditures were $936.6 million.

In 1959—and this is an estimate of course—$973.8 million.

Estimated for 1960, $1,031.6 million.

Now, this is an increasing level of activity.

Senator O'MAHONEY. I know, Mr. Saulnier. But take the development of the Upper Colorado River Basin, for example, that was brought about finally by the insistence of Congress to get the project authorized. But now we are confronted by a declaration in the budget that you are going to stop this development.

I point out to you—and you can get the evidence from the Reclamation Service, you can get the information from the Corps of Engineers—that the waters of the United States are continuing to waste into the ocean while Soviet Russia is engaged in a high-pressure campaign to conserve its waterpower, to expand its waterpower.

Mr. SAULNIER. Senator, I shall not pretend to be an expert on water engineering or water resources. All I can say is that we are actually spending more, year after year, on this activity.

Senator O'MAHONEY. I am sorry, Mr. Saulnier. I am called to the telephone.

I shall write you a letter.

Mr. SAULNIER. That will continue what is; for me, sir, a pleasant correspondence.

Senator O'MAHONEY. Thank you.

The CHAIRMAN. I was going to say, without wishing to curtail other members of the committee that I think we could spare the witness somewhat if we could take not more than 5 minutes.

Representative CURTIS. I wanted to compliment Dr. Saulnier on his answers to Senator Douglas' inquiry. I would like to point out two things. One is to note that comparisons with 1952 should recognize that we were then in a war. And gross national product, of course, measures our activity. And I think there is another economic factor that is very significant. That is our capacity, of course. And in wartime we do tend to utilize more capacity than otherwise.

So that it is unfortunate to take a breaking point of 1952 which was a war year in comparing others. But I think these other factors that were brought out brought that out in another way. I mention that for your comment.

Mr. SAULNIER. I have tried to pick some periods for comparison that are entirely fair. I am interested only in elucidating a point concerning the growth of our economy.

I think it is an interesting point that the private economy grew more rapidly in the years 1952–57 than in the years 1947–52.

Representative CURTIS. Yes.

One other point that I think should be stressed in regard to the growth in Western Europe: Economically a great deal of that can be attributed to our own economy. Certainly much of the capital formation over there came about because of the transfers and aid from our economy. Perhaps to make a fair comparison we ought to get some credit in the economic figures for some of that growth abroad. I don't know how we would measure it, but on the other hand I think it is a pertinent thing to keep in mind. Wouldn't you say that, Dr. Saulnier?

Mr. SAULNIER. It is a pertinent matter to observe. And we have benefited, too, by the strengthening of our allies. I have nothing but the greatest pleasure in the fact that they have grown so rapidly. I am sure we all feel that way about it.

Representative CURTIS. On page 11, you have some charts on the manufacturing capacity which I think show that it increased by about one-fourth between 1953 and 1957 and while production was increasing only about 7 percent. This is in line with what I was talking about before. As a matter of fact most of that 7 percent increase in production was realized by the end of the third quarter of 1955.

Now, on page 20 of the report, I am going to read this statement, the first paragraph at the top of the page.

> Third, substantial increases in costs in recent years have influenced prices, large additions to productivity capacity in the replacement of this period of facilities originally acquired when prices were lower have caused capital costs to mount sharply. The rapidly enlarging complement of professional and technical personnel has also added to cost, though inevitably the full beneficial effects of these larger staffs will be realized only over an extended period of time. Since commensurate gains in output have not occurred, these increases in costs have resulted in higher expenses per unit of output produced.

Now, what factors in your judgment were responsible for the limited increase in production while capacity continued to expand?

I had already commented on that. But I wonder if you would comment further.

Mr. SAULNIER. That is, of course, a very difficult question—why there wasn't a larger increase——

Representative CURTIS. Well, Doctor, rather than answer this now, and for the sake of time, there are a series of questions based on that that I will ask and then turn it over to you. And then if you will respond.

One is, what factors were responsible for the limited increase in production while capacity continued to expand?

Second, were restrictive monetary and fiscal policies major factors in limiting increase in output?

If output had increased more rapidly, wouldn't unit production costs have been lower?

And then finally: Isn't it likely that by persisting in restraining demand in 1956–57, restrictive public policies in fact sacrificed growth in product without significantly limiting inflationary price developments?

I don't agree with any implications in that last question.

Mr. SAULNIER. I will be glad to prepare responses for you.

(The material referred to follows:)

THE CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS,
*Washington, D. C., February 18, 1959.*

HON. THOMAS B. CURTIS,
*House of Representatives,*
*Washington, D.C.*

DEAR TOM: I am setting down in this letter the thoughts that have occurred to me and to my associates on the Council of Economic Advisers in connection with the questions you posed at the recent hearings of the Joint Economic Committee.

First, you ask what factors were responsible for the limited increase in production (I assume that you refer to manufacturing output) between 1953 and 1957, despite a considerable expansion of capacity during these years.

In this connection it is well to bear in mind, first, that capital expansion tends, in a free economy, to proceed at an uneven pace. While I should prefer to have it otherwise, and public policy may be properly directed to making it otherwise, the fact is that in our economy we tend to expand physical plant and facilities in a pulse-like fashion, not at an even rate. The years 1956–57 witnessed a rapid growth of capacity in many lines; we are now in a period, perhaps approaching its end, when capacity is being expanded at a much lower rate. One of the consequences of this uneven rate of capital expenditures is a disparity, from time to time, between statistical estimates of capacity and of output.

Second, we must not forget that available indexes of manufacturing capacity and industrial output measure aggregates of different composition. Furthermore, there is room for considerable variation, within aggregate manufacturing capacity, in the relation between capacity and output in particular lines of industry. We must be mindful also of further shortcomings of conventional measures of capacity. For example, capital equipment and plants remain on the books of business concerns as available standby capacity a considerable time after they cease to be maintained in optimum working order. Such facilities would be usable only at relatively high costs, and will eventually be retired because of the greater efficiency of newer plants. Nevertheless, economic statistics continue to reflect this secondary capacity, without regard to the extent of its utilization.

Finally, the disparities that are apparent in conventional measures of output and capacity are affected by shifts in demand, in which the years 1953–57 abounded. For example, the fact that the demand for new housing, for automobiles, and for certain other consumer durable goods declined after 1955, at a time when overall capital expansion and modernization was still advancing, accounts for a good part of the disparity suggested by the statistics.

This is not to say, however, that the disparity between capacity and output that developed in the period 1953–57 was inevitable, or that a large amount of excess industrial capacity must necessarily be a feature of our economy in the years ahead. I believe we would have been better off if we had avoided the price increases that occurred in part of this period, notably in the heavy industries and in those producing automobiles and other consumer durables. In my judgment, these price increases were a major factor in limiting demand, and thereby restraining output.

You also ask whether restrictive monetary and fiscal policies were major fators in limiting increases in output in 1953–57. In my opinion, the record of monetary and fiscal policy in these years is a good one. At times, a restrictive policy was needed. Indeed, if production in some of our consumer durable goods industries had increased less rapidly in 1955, and if capital expansion had been more moderate in 1956, economic growth might well have been better maintained after 1957. Of course, the growth rate of real ouput would have been less than the actual rate of the years before the 1957–58 recession, but we might have had an even milder recession than we had and the growth rate might have been better sustained. To the extent that monetary and fiscal policy tended to be restrictive at some points in this period, it was helping to achieve a better rate of long-term growth. I hesitate to contemplate what the consequences would have been if financial policies prohibiting still higher purchases of consumer durables and higher rates of capacity expansion had been followed in these years.

Your third question can be answered very briefly. Other things being equal, if output had increased more rapidly, unit production costs would have been lower than they turned out to be. The important question for public policy is how to achieve the high (and sustainable rate) rate of output that will give us the benefits of low unit production costs. I think we can best accomplish this result under the economic program put forward by the President in the Economic Report of January 1959.

With respect to your fourth question, it is my judgment that the monetary and fiscal policies followed in 1956 and 1957 did limit inflationary price developments, and helped maintain our record of long-term economic growth by helping to prevent a more severe economic recession than actually occurred. Repeating what I said above in other words, had we followed an easier money policy and disregarded considerations of fiscal prudence we would almost certainly have had more inflation in this period, a more drastic recession in 1957–58 (with greater disparities between capacity and output), and a lower rate of overall economic growth.

As ever, with warm regards.

RAYMOND J. SAULNIER.

The CHAIRMAN. Mr. Reuss.

Representative REUSS. Mr. Sauliner, as I have indicated, I am disturbed and less than satisfied by the fact that 6-plus percent of our working force is unemployed and that something around a quarter of our manufacturing capacity is not being utilized.

I note that the Economic Report is silent about monetary and credit policies for the upcoming year. I would like to ask this question— What are the assumptions of the Council of Economic Advisers about the necessary growth in the monetary supply for the upcoming year in order to carry out the goals of the Employment Act?

Mr. SAULNIER. There are no specific assumptions in the Economic Report with respect to the growth of the money supply.

Representative REUSS. I know there are none in the report. My question is, What do you think we should have?

Mr. SAULNIER. In recent months we have had both a contraction in money supply and an expansion. In the second half of 1957 we had some contraction of the money supply. Defining money supply as demand deposits, plus currency. Then, beginning early in 1958 we had a very rapid expansion of the money supply. It not only made up for the decline that took place in the last 6 months of 1957, but went beyond that.

And there was an increase over the period as a whole.

If you take from July 1957 to July 1958, you will find a small increase in money supply. Approximately $1,600 million. That is a bit over 1 percent.

But if you go from December 1957 to December 1958, you find a much sharper increase: A bit over $5 billion, which is about a 3-percent or about a 4-percent increase.

Now that is a very sharp increase. I would not expect that to be sustained over any period of time.

Representative REUSS. When you say "expect," do you mean desired and think proper?

Mr. SAULNIER. Yes.

Representative REUSS. On the order of what percentage increase for the year 1959?

Mr. SAULNIER. Well, 2 percent is pretty close to the historical rate.

Representative REUSS. And this is what you would think desirable?

Mr. SAULNIER. Over our history that has been roughly adequate as an expansion of the circulating medium.

Let me say, Congressman Reuss, that there are some conceptual problems here that are very difficult, that is, in the definition of "money supply."

Representative REUSS. But you mean demand deposits plus currency?

Mr. SAULNIER. That is correct.

Representative REUSS. Thank you, Mr. Chairman.

Mr. SAULNIER. May I say this: We have not said anything in the Economic Report, of course, about what we think money policy ought to be.

Representative REUSS. Yes. I think you should, as you know, but you disagree. We won't talk about that.

Mr. SAULNIER. I do disagree. And you know my reasons for it. If I were a private citizen, I would have lots of views to express on money policy. But as a Government official, I think it would be a wrong thing for me to do.

Representative REUSS. As I say, we disagree.

The CHAIRMAN. If there are no further questions we thank you gentlemen for appearing.

I am going to request to have inserted in the record at appropriate points, statistics of various rates of growth.

I will ask the minority if they will be willing to check these figures as they are entered and if jointly approved they will be made a part of the record.

Mr. CURTIS. We have no objection to the inclusion of any figures which the chairman wishes. This type of figure is, however, subject to a great deal of conceptual and statistical problems and I would want to reserve the right to study them pretty thoroughly before approving them or drawing any implications from them.

(At the request of Congressman Bolling the following is made a part of the record:)

FEBRUARY 2, 1959.

Dr. RAYMOND J. SAULNIER,
*Chairman, Council of Economic Advisers, Executive Office Building, Washington, D.C.*

DEAR DR. SAULNIER: At the time of your appearance before the Joint Economics Committee, last Tuesday, January 27, I was, to my regret, unavoidably absent from the city. Since my return I have read the committee record with interest. I am now writing to request you to submit answers, supplementing your testimony, to a few questions that I would have raised had I been present and that do not appear to have been dealt with either in your prepared statement or in the questioning that followed.

On page 48, the Economic Report states that "a persistent upward movement of prices would do great harm to our economy." We must, of course, be constantly on guard against the economic and social damage that can result from inflation—and seek both to prevent inflation and to remedy such damage as may be suffered. It is necessary, however, to weigh the cost of vigorous anti-inflation policies and measures in terms of underemployment of our resources and limitation on our economic growth. If these considerations were not sufficiently pressing, the challenge offered us by the Soviet Union should be a constant reminder that we neglect them only at our grave national peril. With this in mind, I draw your attention to the fact that the statistical record shows that in the 25 years since 1933 prices have increased (as indicated by the implicit deflators of the GNP, p. 144 of the Economic Report) an all but 3 years, and that in the 13 years since the end of World War II prices have increased in every year but one.

My questions are these:

Has this "persistent upward movement of prices" actually done great harm to the economy?

If so, in what respect?

During this long period, the upward price movement has both accelerated and slowed down. Therefore I also ask:

Is there any reason to assume that a mild acceleration will necessarily turn into a rapid one?

Finally, let me ask you to appraise the relative importance to economic growth of price stability, on the one hand, and of minimum unemployment, on the other. (In this connection you may be interested in today's statement by Prof. Robert Eisner, copy of which I enclose.)

Because I was unable also to be present when Mr. Stans testified before the committee, I am writing to him today, raising questions that I would have asked him had I been at the hearing. A copy of my letter to him is enclosed. If there is any comment you are in position to make on the issues raised by the questions I have asked him, please include it in your response to the foregoing.

Sincerely yours,

RICHARD BOLLING.

P.S.—After dictating the above, I have read the editorial in Business Week for January 31. I suggest accordingly that in your reply you keep in mind also Professor Hansen's comparisons of recent price movements with those dating from as far back as 1897. R. B.

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS,
*Washington, February 18, 1959.*

Hon. RICHARD BOLLING,
*House of Representatives,*
*Washington, D.C.*

DEAR MR. BOLLING: This letter is in response to yours of February 2, 1959, in which you asked for my views on several questions having to do with inflation.

First, you called my attention to the price increases that occurred in the 25 years since 1933, and asked whether this "persistent" upward movement of prices actually harmed the economy.

There can be no doubt but that it did, and particularly when we consider the impact of inflation on the well-being of all segments of our population, as well as its effect on the productive efficiency of our economy. Viewed from the welfare standpoint, the fact that stands out most clearly is that price increases in the last 25 years, during which the index of consumer prices rose almost 125 percent, have deprived millions of Americans of purchasing power put aside in savings. Whatever else we can say for the history of these 25 years, we must concede that it dealt harshly with those who placed their savings in fixed-income assets. It was not a happy history for people who made prudent provision for their retirement years only to find when they reached that time that their resources were inadequate to cope with the inflated price level. Surely no one would want to repeat this history.

Another example of the ill effect of inflation is to be found in the field of education. Inflation creates an incentive for people coming into the labor force to move into occupations where incomes have increased most nearly in accordance with prices. Teaching happens to be a profession in which salaries are not quickly adjusted to price changes. As a result, we have created the teacher shortage problem that has plagued us in recent years and is only now being solved. Parallel problems have been created for other occupations that are important for the security and welfare of our country. These situations illustrate some of the ways inflation damages our economy and our society. And the damage it does can never be fully repaired.

Let me turn now to an aspect of your question that is suggested by the use of the word "persistent" in connection with the price increases of the last 25 25 years. Actually, consumer price increases from 1933 through 1958 were more spasmodic than persistent. Thus, close to 75 percent of the increase in the consumer price index that occurred in this 25-year period came in the years 1941–48 and 1950–51, all of them war, or immediate postwar, years. The price rise that occurred between 1956 and 1958, and which accounted for nearly half of the remaining inflation of the 25-year period, must be differentiated, I believe, from these war and immediate postwar price increases. It raises a very different question from those raised by the war and postwar price rises, namely, whether prices can be held reasonably stable in a free economy during peacetime while economic resources are employed at close to full capacity.

In my judgment, increases in wages and other employee compensation have been a major factor making for the price increases that have occurred since mid-1956, and these price increases have in turn been a major factor in limiting real demand. But wage increases were not the only factor at work. The rapid expansion of capital in recent years, reaching boom proportions in 1956, added materially to the cost and price rise. And I would not entirely absolve Government from responsibility for some part of the end result. To a large extent, the momentum of the rise was due to the expectation that costs and prices would be still higher later on, and so-called escalator clauses assured the rapid spread of increases through the economy. As price and cost increases were diffused through the economy they tended, I believe, to weaken the conditions necessary for sustained economic growth. If prices had been held within narrower limits, I believe we would have had a higher, better balanced, and more sustained expansion.

The lesson to be learned from this history is clear. We can achieve a higher and more stable rate of economic growth in the future if we are successful in holding prices and costs more stable. In his most recent Economic Report, the President put forward a program that will help assure this result.

In your second question you asked whether there is any reason to assume that a mild acceleration of price advances will necessarily turn into a rapid one. My answer is "Yes": There is a good reason to assume this might happen.

Unquestionably the forces at work in the price system tend in that direction. And there is also good reason to assume that a period of accelerated price increase would lead to serious economic imbalance. In other words, I am quite sure that even a little bit of inflation involves dangers that no one should deliberately court.

Finally, you asked me to appraise the relative importance to economic growth of price stability on the one hand, and of minimum unemployment on the other.

I am not sure I fully understand this question, but it suggests that we must make a choice between price stability and minimum unemployment, that we cannot have both, only one or the other, and that we must resign ourselves to a little inflation in order to have as few people unemployed as possible.

I cannot accept this line of argument at all. I do not think you can make acceptance of a little inflation a basis of public policy without engendering the reactions that will ultimately, and shortly, cause the policy to fail. This is a formula for increasing, not decreasing, unemployment, if we take anything but a very short view of the economic process in a free competitive system.

There is a far better formula for minimizing unemployment. It is to bring into useful employment all those willing and able to work by enhancing the incentives which are basic to growth on a free economy. The President's economic program, described in the Economic Report of January 1959, supplies the particulars of such a program.

As you know, I believe that the prospect for reasonable stability of consumer prices and for the steady and sustained growth of our economy is good in the foreseeable future. Much depends, of course, on the kind of public and private policies we follow. But success is well within our reach if along with appropriate monetary and debt management policies, we follow the President's 1960 financial plan. This plan will bring closer to hand the possibility of constructive, incentive-increasing tax reform and reduction and thereby give a signficant stimulus to the growth and improvement of our economy.

With warm regards.

Sincerely,

RAYMOND J. SAULNIER.

Tomorrow we will meet in room 362 of the Old House Office Building at 10 o'clock and Mr. Stans, Director of the Bureau of the Budget will be there.

Thank you very much.

Mr. SAULNIER. Thank you, sir.

(Whereupon, at 12:15 p.m., the committee adjourned, to reconvene at 10 a.m., Wednesday, January 28, 1959, room 362, Old House Office Building.)

# JANUARY 1959 ECONOMIC REPORT OF THE PRESIDENT

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**WEDNESDAY, JANUARY 28, 1959**

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met at 10 a.m., pursuant to recess, in room 362, Old House Office Building, Hon. Paul H. Douglas (chairman) presiding.

Present: Senators Douglas, O'Mahoney; Representatives Reuss, Patman, Curtis, Kilburn, and Widnall.

Also present: Roderick H. Riley, executive director; John W. Lehman, clerk.

The CHAIRMAN. First, let me say that we are very glad to welcome Congressman Widnall, who has been officially named to this committee as one of the minority Members from the House. We are happy to have him with us. And there may be other additions to the committee.

Today the Joint Economic Committee continues public hearings on the President's Economic Report. That report is submitted each year at this time. And the responsibility of this committee is to examine it to determine to what extent the Economic Report and the budget which is coupled with it carry out the objectives of the Employment Act of 1946.

There are many people who would judge the program and the Ecomonic Report in the budget almost exclusively in terms of whether it will help to prevent inflation.

There are others who are concerned solely with keeping unemployment just as low as possible. The fact of the matter is that we must strive to do both. In addition we should also seek to secure maximum production which may reflect the growing capacity of our economy.

It seems that this threefold nature of our economic policy objective—namely, full employment or substantially full employment, price stability, and economic growth—is seriously neglected in this year's Economic Report. The report tends instead to be concerned far more about inflation than about unemployment and the virtual stagnation of the level of production during the past 3 years. We have not had in recent years the classical type of inflation where too much money chases too few goods. The fact is that we have had an excess of goods and a productive capacity which has not been used to the full. Further, we have seen large declines in farm and raw material prices.

Thus the increase in the general level of wholesale prices and of the retail cost of living index has largely been in industrial prices. And we have not had a classical demand pull inflation. For some reason the recession that is still with us, the recession which was not even mentioned by that name in last year's report, is treated as virtually over. No particular concern is shown for the disturbingly high volume of unemployment that still persists. And on page after page the theme of price stability is stressed while other objectives are ignored or given scant attention; yet, important as it is to prevent inflation, serious as persistently rising prices can be for our economy and our social fabric, our public economic policies must apprise a great deal more than price stability.

The objectives of the Employment Act are the promotion of maximum employment, production, and purchasing power. What the act calls for, therefore, is the simultaneous achievement of three objectives, not just one. Employment cannot be at a maximum, cannot even be satisfactorily high when over 6 percent of the labor force is unemployed. For these 4,100,000 Americans, the recession is by no means over. And this large number of unemployed persons includes hundreds of thousands who are pinned down in the depressed areas of the country where the percentages are a great deal higher than 6 percent.

Furthermore, even the figure of 4.1 million does not tell the whole story. If we take account of the part-time and short-time work—and I refer to involuntary part-time and short-time—to which many workers are limited by the recession, the total full-time equivalent of unemployment comes at least to 5.1 million, or well over 7 percent. One doesn't have to be an extremist about the prevention of unemployment to be deeply disturbed both that this situation should continue to prevail and that the Economic Report should blandly pass it over.

We know that production is not at a maximum when the volume of our gross national product stands at the same level it did at the end of 1956, despite the growth in productive capacity since that time. Indeed, our industrial output is only now getting back up to the level achieved more than 3 years ago in 1955. That is why I am disturbed to read in the Economic Report that—

> we may justifiably take satisfaction in the increases already achieved in employment, production, and incomes.

That is why I for one can take little satisfaction even in the fact, as the report adds, that the "price level has been reasonably steady of late."

We have had reasonably steady prices in recent months. All the more reason for surprise that the Economic Report places such emphasis on preventing inflation. We have not had anything like a satisfactory increase in employment or production. And there is reason to believe that we are not at maximum levels of employment and production, because our prices have been geared too heavily to holding down prices. And it would appear that while the major price increases have been limited to the industrial price sector, the anti-inflation policies have been such as to deflate prices across the board, many of which, including farm and raw material prices, have been falling sharply in the period.

There is a great deal said in the Economic Report about growth but little about its achievement. In economics as elsewhere, however, it is performance that counts, not talk. In past years this country has demonstrated an ability to lift national output quarter after quarter, to keep unemployment at a low percentage of the labor force, to maintain and improve our plant and equipment, both public and private, and still to have prices that are reasonably steady. This is a combination of objectives that can be attained and that must be attained if the purpose of the Employment Act is to be carried out.

That purpose, moreover, is one that in today's divided world is far more serious, far more important to our national welfare and even our national security than the authors of the act could possibly have supposed.

So with these fundamental objectives, the Employment Act before us, the attainment of maximum employment, production, purchasing power and price stability, the Joint Economic Committee will hear this morning from Mr. Maurice H. Stans, Director of the Bureau of the Budget.

Representative CURTIS. Mr. Chairman, I regret that we start off these hearings with a statement of the chairman's presenting conclusions before we have even held the hearings. I didn't realize that we were going to have a political speech to start these hearings. I disagree with a great deal of what the gentleman has said. And I suspect these hearings will bring out the incorrectness, of some of the conclusions he has drawn.

But the main point I wish to stress now is that we are supposed to draw conclusions after the hearings and not before. I believe the record should show that what we have just heard is the chairman's personal views and not the views of this committee at all.

The CHAIRMAN. I am very glad to have the record show that. It has been customary in the past for the chairman to make a preliminary statement at the opening of the hearings. I was merely following out that tradition.

Let the record show that that was my own personal statement.

Representative CURTIS. Yes. But, Mr. Chairman, I don't believe it has been the custom to draw the conclusions as to what the Economic Report contains or doesn't contain in that fashion, because otherwise, the hearings would be prejudged before they were held.

The CHAIRMAN. Well, may I say that I will be very glad to have the gentleman from Missouri present his version on the record at any time on what he thinks the report contains.

Representative REUSS. Mr. Chairman, at this point lest it be thought that no one shares the personal views of the chairman, I would like to say that I have listened to them and find that his tentative observations are almost identical with my own. Of course all members are going to listen carefully to the testimony throughout the hearings and revise tentative conclusions as revision appears necessary.

The CHAIRMAN. I may say that I think all members of the committee are able to read. The chairman once passed an examination in reading. He has read the report quite carefully.

Representative CURTIS. So have I. And I disagree with many of your statements and your conclusions.

Representative KILBURN. Mr. Chairman, as long as the gentleman from Wisconsin speaks on this, I back up Mr. Curtis on this.

The CHAIRMAN. Any further testimony?

Representative PATMAN. I assume that the chairman's conclusions are by reason of the fact that he has carefully read the report and is merely giving his opinion.

The CHAIRMAN. That is right.

Representative PATMAN. His opinions—the ones that I have just heard and listened to—I must say that I too share.

The CHAIRMAN. Mr. Widnall, do you wish to speak on this matter?

Representative WIDNALL. Mr. Chairman, I might add that I support Mr. Curtis. But I was surprised in reading the Congressional Record today and seeing what was classified as "depressed areas" in my district when they weren't even in my district. Somebody inserted in the Record today, or yesterday, a list of a number of places that don't affect my district at all.

The CHAIRMAN. Well, I may say I am not responsible.

Representative WIDNALL. I suppose the idea of it is to show there isn't one place in the United States that isn't depressed.

The CHAIRMAN. May I say I am not responsible for entries made on the House Record. Now, Mr. Stans, we are very glad to have you with us.

Mr. STANS. Thank you, Mr. Chairman.

## STATEMENT OF MAURICE H. STANS, DIRECTOR OF THE BUREAU OF THE BUDGET, ACCOMPANIED BY ROGER W. JONES, DEPUTY DIRECTOR; ELMER B. STAATS, ASSISTANT DIRECTOR; RAYMOND T. BOWMAN, ASSISTANT DIRECTOR FOR STATISTICAL STANDARDS; WILLIAM F. McCANDLESS, ASSISANT DIRECTOR FOR BUDGET REVIEW; AND SAMUEL M. COHN, CHIEF OF FISCAL ANALYSIS

Mr. STANS. Mr. Chairman and members of the committee, I know this committee recognizes the importance of the Nation's economy of actions on the President's budget proposals. Therefore, I welcome this opportunity to talk to you about the 1960 budget, and look forward to cooperating with this and other committees of the Congress toward the objective of a sound fiscal policy that will help promote economic growth and price stability.

In this statement, I shall discuss the expeditures of the Federal Government. I understand that the Secretary of the Treasury has been invited and will appear before you to discuss revenues and new revenue proposals.

The President has made clear his conviction that the budget expenditures of the Federal Government should be in balance with receipts for the fiscal year 1960. The period covered by this budget—starting next July and ending 17 months from now—is expected to be one of unprecedented prosperity. Even now, with recovery not yet complete, personal income and gross national product have reached alltime highs.

It is the administration's position that in a period of growing prosperity, following hard on the heels of our largest peacetime deficit, the Government should live within its income, particularly in light of the present high level of general tax rates. It is the only course that is consistent with fiscal responsibility.

A continuation of unbalanced budgets with a piling up of deficits, especially during such periods, would create inflationary pressures and cheapen the value of our money. Inflation, as we all know, is an unfair and hidden tax on personal incomes, savings, pensions, and insurance.

Of course, in reaching a balanced budget in 1960 we expect to get most of our help from improved receipts. On the expenditure side, we have provided first for national security needs and other essential activities while working also for the objective of a balanced budget.

Mr. Chairman, in my statement I have a table showing the budget totals for the 4 fiscal years 1957 through 1960. You will note that, first, budget expenditures are estimated to be $3.9 billion less in 1960 than in 1959; and, second, there is a small estimated surplus in 1960, which actually amounts to $70 million.

(The table referred to follows:)

*Budget totals*

[Fiscal years—In billions]

| | 1957 actual | 1958 actual | 1959 estimate | 1960 estimate |
|---|---|---|---|---|
| Budget receipts | $71.0 | $69.1 | $68.0 | $77.1 |
| Budget expenditures | 69.4 | 71.9 | 80.9 | 77.0 |
| Budget surplus (+) or deficit (−) | +1.6 | −2.8 | −12.9 | +0.1 |
| New obligational authority | 70.2 | 76.3 | 82.4 | 76.8 |

Mr. STANS. The committee may be interested in knowing the factors which account for the $3.9 billion decrease in the budget expenditure totals between 1959 and 1960. I would like to submit for the record the attached table 1 listing the major increases and decreases in 1960.

(The table 1 follows:)

TABLE 1.—*Reconciliation between 1959 and 1960 budgeted expenditures*

[In millions]

| | | |
|---|---|---|
| 1959 expenditures (latest estimate, as shown in 1960 budget) | | $80,871 |
| 1. Nonrecurring 1959 item (supplemental), International Monetary Fund capital contribution | | −1,375 |
| Total | | 79,496 |
| 2. Terminated temporary programs: | | |
| Acreage reserve (less increase in conservation reserve) | $510 | |
| Augmentation of unemployment benefits | 412 | |
| Purchase of low-cost housing mortgages by FNMA | 358 | |
| | | −1,280 |
| Total | | 78,216 |
| 3. Uncontrollable major increases: | | |
| Interest on debt | $500 | |
| Construction of public works, buildings and ships (committed) | 217 | |
| New outer space and defense education programs | 172 | |
| | | +889 |
| Total | | 79,105 |
| 4. Normal decreases: | | |
| CCC program | $253 | |
| Postal revenues (1958 law and 4th class increase) | 177 | |
| Retroactive pay in 1958, net | 265 | |
| | | −695 |
| Total | | 78,410 |

TABLE 1.—*Reconciliation between 1959 and 1960 budgeted expenditures*—Con.

[In millions—Continued]

| | | |
|---|---|---|
| 5. Legislative proposals for reduction in 1960: | | |
| Postal rate increases | $350 | |
| Veterans' loans | 33 | |
| Transfer to trust fund of cost of forest and public lands highways in interstate system | 32 | |
| | | —$415 |
| Total | | 77,995 |
| 6. Sales of assets in 1960: | | |
| FNMA mortgages | $335 | |
| College housing loans | 50 | |
| Export-Import Bank loans | 234 | |
| | | —619 |
| Total | | 77,376 |
| 7. All other changes, other decreases in programs (including military assistance $462), less other increases in programs | | —346 |
| 1960 expenditures | | 77,030 |

Mr. STANS. As that table shows, a nonrecurring item recommended for 1959 accounts for the largest single decrease. This item is the proposed additional United States subscription to the International Monetary Fund.

Next, three large temporary programs are terminating. These are the acreage reserve, the temporary advances to States for extended unemployment compensation, and the special purchases of mortgages on low-cost housing.

Third, certain major increases which are largely uncontrollable for the 1960 budget will partially offset the decreases just listed. Interest payments on the public debt are estimated to rise. Past commitments will lead to larger expenditures for construction of civil public works and of merchant ships. Space exploration and the defense education program enacted in 1958 also involve higher expenditures.

Fourth, some other significant decreases will occur in the normal course of events without special congressional or administrative action. Farm price support payments are estimated to be lower than in 1959 but higher than in 1958. The Department of Agriculture expects that crop yields in calendar 1959 will not be as high as in calendar 1958, when yields were an unprecedented 11 percent above the previous record level.

The increase in postal rates enacted last year and the parcel post rate increase to be made administratively this year will have a fuller effect in 1960 and will thus reduce net expenditures of the Post Office Department. Moreover, the expenditures in 1959 for retroactive pay raises will not recur.

Fifth, legislation is being proposed which, if enacted, will bring reductions of $415 million in net budget expenditures in 1960. These proposals include increased postal rates, more flexible interest rates on guaranteed loans to veterans, and a transfer to trust-fund financing of Federal-aid highways in national forests and public lands.

Sixth, certain housing programs and the Export-Import Bank are proposed to be made self-financing in 1960 by stepping up the sale of portfolio assets, in some cases by exchanging them for Government bonds. Thus, disbursements for new loans or mortgage purchases would be covered by realization on old ones.

Finally, the net effect of all other changes between 1959 and 1960 is a decrease of $346 million. The largest item in this category is an estimated decrease of $462 million in expenditures for military assistance.

I believe that this table clearly shows that the recommended reduction in the total of budget expenditures is not being achieved by proposals which would impair the security and welfare of the country. The major budgetary action has been, after providing for the national defense to restrain large increases which could not be financed from current revenues.

In addition to those legislative proposals which will bring reductions in 1960 budget expenditures—and which were shown in item 5 of the table just referred to—the budget contains recommendations for other legislation to achieve long-run economies by adapting programs to change circumstances.

These proposals to adjust programs in the light of current conditions would bring budgetary savings in the years beyond 1960. Together with the rise in revenues from a growing economy, they could produce surpluses which might be applied to reduce the public debt, to lessen the burden of taxes, or to meet the cost of essential new Government services—some of which will inevitably be needed as our Nation grows and progresses.

For this committee, which is interested in studying the economic impact of the budget, the consolidated figures of Federal receipts from and payments to the public are at least as important as the regular budget totals. These consolidated figures cover both budget and trust-fund transactions and eliminate intragovernmental and noncash transactions.

The following table gives these consolidated totals for the fiscal years 1957 through 1960.

I ask that this table be included in the record.

(The table referred to follows:)

*Federal Government receipts from and payments to the public*

[Fiscal years—in billions]

| | 1957 actual | 1958 actual | 1959 estimate | 1960 estimate |
|---|---|---|---|---|
| Receipts from the public | $82.1 | $81.9 | $81.7 | $93.5 |
| Payments to the public | 80.0 | 83.4 | 94.9 | 92.9 |
| Excess of receipts over payments | 2.1 | | | .6 |
| Excess of payments over receipts | | 1.5 | 13.2 | |

Mr. STANS. As this table shows, total Federal receipts from the public in fiscal 1960 are expected to exceed payments to the public by $626 million. This figure exceeds the budget surplus in 1960 mainly because (1) cash payments of interest on redeemed savings bonds are less than the accrued interest included in budget expenditures and (2) trust fund receipts exceed trust fund expenditures.

I would like to supply for the record the attached table 2 which gives Federal payments to the public by function for 1958, 1959, and 1960 along with 1948 for comparative purposes.

(The table 2 referred to follows:)

TABLE 2.—*Federal payments to the public by major functions—Includes budget and trust funds; excludes major intragovernmental and noncash transactions*

[Fiscal years—in millions]

| Function | 1948 actual | 1958 actual | 1959 estimate | 1960 estimate |
|---|---|---|---|---|
| Major national security | $12,998 | $44,460 | $46,450 | $45,914 |
| International affairs and finance | 5,542 | 2,668 | 2,510 | 2,099 |
| Veterans' services and benefits | 6,904 | 5,682 | 5,856 | 5,742 |
| Labor and welfare | 3,149 | 16,140 | 18,497 | 19,056 |
| Agriculture and agricultural resources | 531 | 4,321 | 7,024 | 5,875 |
| Natural resources | 755 | 1,570 | 1,741 | 1,735 |
| Commerce and housing | 449 | 2,996 | 6,656 | 5,579 |
| General government | 1,385 | 1,620 | 1,974 | 2,082 |
| Interest [1] | 3,909 | 5,883 | 5,636 | 6,250 |
| Deposit funds, net [2] | 73 | −97 | 29 | 2 |
| Allowance for contingencies | | | 200 | 100 |
| Subtotal | 35,695 | 85,243 | 96,573 | 94,434 |
| Expenditures by agencies, as employers, for Federal employees' retirement (−) [3] | | −586 | −749 | −723 |
| Deduction from Federal employees' salaries for retirement (−) | −236 | −666 | −748 | −723 |
| Increase (−) or decrease in clearing account for outstanding checks, etc.[4] | 507 | −579 | −177 | −112 |
| Adjustment to daily Treasury statement basis | 527 | | | |
| Total Federal payments to the public | 36,493 | 83,413 | 94,899 | 92,875 |

[1] Since 1954, includes adjustment for change in public debt interest checks, coupons, and accruals outstanding.

[2] Excludes deposit funds of Government-sponsored enterprises which are allocated by major function.

[3] In 1957 and prior years the Government's payment as employer was made in a lump sum to the Civil Service Commission and was not included in any functional category as a payment to the public. From 1958, the individual agency payments are included in the applicable functional category, but the total is deducted from payments in a lump sum.

[4] Since 1954, excludes that part of clearing account which is for public debt interest checks, coupons, and accruals outstanding.

Mr. STANS. Detailed figures covering all the intervening years as well appear on page 929 of the 1960 budget document.

From 1948 to 1960, total Federal payments to the public increase at a faster rate than budget expenditures over this period. This faster growth reflects (1) rising outlays from some of the older trust funds, particularly the old-age and survivors insurance fund, and (2) the payments from new trust funds created since 1948, such as those for highways and the secondary market operations of the Federal National Mortgage Association.

In 1948, total Federal payments to the public were $36.5 billion. In 1960, they are estimated to be $92.9 billion.

With two exceptions, paymentsfor every function of the Government will be higher in 1960 than in 1948. These exceptions are international affairs and veterans' benefits, for which special post-World War II conditions led to higher expenditures in 1948.

Of course, the largest dollar change since 1948, as is to be expected when comparisons are made with a period prior to the Korean conflict, is in major national security.

Apart from the major national security programs, by far the largest amount of payments—and the largest increase since 1948—on a consolidated cash basis are for the labor and welfare activities of the Government.

Federal payments for labor and welfare programs are estimated to be over $19 billion in 1960. This total is $15.9 billion more than in 1948. The amounts involved are much larger than the budget expenditures for these programs because of the benefit payments from social security and retirement trust funds.

The table shows that payments for two other functions are estimated to increase by more than $5 billion between 1948 and 1960. These are commerce and housing, and agriculture. The first reflects, among other factors, the sharp rise in grants for Federal-aid highways; the second, the increase in farm price support payments from a period when they were probably abnormally low because of special post-World War II conditions.

In conclusion, I would like to repeat my belief that, whether we look at regular budget expenditures of $77 billion or the total payments to the public of $93 billion in 1960, the Government is not balancing its income and outgo at the expense of essentials.

Practically all of the programs of the Government under this budget will continue at very high levels.

I hope that the Congress will accept and approve the general policy and dimensions of the budget recommended by the President.

It is my sincere belief that the best interests of the country would be served if the executive and legislative branches work together to balance the 1960 budget at the proposed level of about $77 billion.

The CHAIRMAN. Thank you very much, Mr. Stans. We will operate under the 10-minute rule. I am going to call on the distinguished vice chairman, Congressman Patman.

Representative PATMAN. Thank you, Mr. Chairman.

I want first to interrogate the distinguished Director of the Bureau of the Budget about interest rates. The Economic Indicators for January 1959 indicate that for 1952 the "net interest" in the national income was $7.1, and it has never decreased during that time. It has increased every year and every quarter since that time—1952.

And now it is 13.2. That is the third quarter, 1958. In other words, almost a hundred percent increase in the net interest paid.

Now that does not include the interest paid on the national debt. Am I correct in that, Mr. Stans?

Mr. STANS. That is correct.

Representative PATMAN. It does not include the $8 billion interest on the national debt.

Mr. STANS. That is correct.

Representative PATMAN. Now, the distressed areas—you say nothing about distressed areas in your statement at all. I assume that is because we don't have the law on the statute books specifically applying to distressed areas.

Mr. STANS. Well, I didn't say anything in my opening statement. But there is a recommendation of the President in the budget message dealing with distressed areas.

Representative PATMAN. I am greatly disturbed by the fact that in our country a distressed area has no place to turn to get credit for the purpose of establishing industries that would employ the people in the distressed areas; whereas, if these same distressed areas were in Canada or Mexico or more than 50 other countries of the world, they would have 5 different agencies supported by the U.S. Government and by our money to help them relieve that distress. But here in our own country, we have no provisions for that.

Now, the counterpart funds, do you keep up with them in the different countries?

Mr. STANS. Yes. We have information with respect to them, Mr. Patman.

Representative PATMAN. Is my estimate of about a billion dollars correct of counterpart funds in different countries, approximately correct?

Well, I don't want to take much time on that if you have to do any research. I wish you would get me up a statement on it. My information is that these counterparts are used by these countries free of charge. You take in France and Germany or England, they are placed usually in the American banks, New York banks, that have branches over there, and perhaps the American Express Co. which is treated as a bank for that purpose. They are there, and the Government receives no interest whatsoever for the use of those funds. I would like for you to give us a statement on that, and what is being done to safeguard the interest of the American taxpayers on the counterpart funds that are on deposit in foreign countries. And particularly I wish you would break down the country of Spain in that analysis.

Mr. STANS. I will be happy to give you that analysis. But may I ask by the term "counterpart funds" you mean all of the funds?

Representative PATMAN. All the funds, including Public Law 480 funds. And I wish you would distinguish between them, please?

(The material referred to follows:)

A large part of the foreign currency received by the United States is required by the terms of the agreement under which it is generated to be made available for use by the foreign government. In the case of counterpart currencies accruing under the mutual security program, the portion to be used by the foreign country is retained by that country and is not taken up in U.S. accounts. In the case of currencies accruing from the sale of surplus agricultural commodities under section 402 of the Mutual Security Act and under the Agricultural Trade Development and Assistance Act of 1954 (Public Law 480), all currencies are deposited to the credit of the U.S. Treasury and the portion to be used by the foreign government is loaned or granted to the country at a later time. In cases where the currency is to be used by the foreign government, the funds may be used only for purposes and on terms concurred in by the U.S. Government. The U.S. control is exercised by the International Cooperation Administration, with the advice as necessary, of the National Advisory Council on International Monetary and Financial Problems.

Foreign currencies which are not committed by international agreement for loans or grants to the foreign country, are available for U.S. programs. Unless provided otherwise by law, these currencies are subject to section 1415 of the Supplemental Appropriation Act of 1953, which prohibits the expenditure of foreign credits owed to or owned by the United States except as may be provided for annually in appropriation acts. These provisions generally require the purchase of the currencies with agency appropriations, and budgetary controls are assured through the regular appropriation process.

All of the currencies which are earmarked for use by the foreign governments are excepted from the provisions of section 1415, as well as currencies available for certain U.S. purposes under Public Law 480. Currencies available for these purposes (excluding the counterpart funds retained by the foreign country) are subject to the same apportionment controls as dollar appropriations, and informational schedules on their availability and use are printed in the budget document.

These funds in U.S. accounts are held in Treasury accounts overseas, managed by Treasury fiscal officers stationed at our Embassies abroad. The bulk of these accounts are held in the central bank of the country (usually in accordance with the agreements made with each country), but sometimes also in the local branches of U.S. banks. Wherever possible and consistent with agreements made, these accounts earn interest, and to the extent feasible they are placed on term deposit in order to increase the interest return. In 1958, over $10 million in interest was received by the Treasury on various foreign currency deposits. Foreign currency receipts from interest, like those from other miscellaneous sources, are available for sale to agency appropriations and the dollars from such sales are credited to miscellaneous receipts.

Counterpart funds retained by the foreign country are managed by its financial officers and subject to its fiscal controls.

Below is a tabulation of foreign currencies owned by the U.S. Government and counterpart funds owned by the respective foreign countries.

*Foreign currencies in the custody of the United States and counterpart funds as of June 30, 1958*

[Dollar equivalents—Millions of dollars]

| | Balances of foreign currencies in the custody of the United States [1] | | | | Counterpart funds (country owned) [2] |
|---|---|---|---|---|---|
| | Acquired through sale of surplus agricultural commodities | | Other | Total in custody of United States | |
| | Public Law 480 | Mutual Security Act | | | |
| Germany, Federal Republic | $0.8 | $31.3 | $40.9 | $73.0 | $9.6 |
| Greece | 11.9 | 10.7 | 2.6 | 25.2 | 123.5 |
| India | 301.0 | 44.1 | 6.2 | 351.3 | |
| Indonesia | 83.6 | | 1.1 | 84.7 | 23.5 |
| Italy | 52.0 | 22.9 | 8.6 | 83.5 | 87.4 |
| Korea | 20.4 | 36.6 | 2.3 | 59.3 | 226.8 |
| Pakistan | 117.4 | 2.7 | 10.9 | 131.0 | 24.6 |
| Poland | 72.8 | | (3) | 72.8 | |
| Spain | 110.5 | 17.6 | 32.0 | 160.1 | 28.2 |
| Turkey | 73.7 | | 9.5 | 83.2 | 11.5 |
| United Kingdom | 26.5 | 38.4 | 2.1 | 67.0 | 1.3 |
| Yugoslavia | 254.0 | 55.9 | 11.5 | 321.4 | 50.4 |
| All other | 224.2 | 58.4 | 25.4 | 308.0 | 209.2 |
| Total | [4] 1,348.8 | [5] 318.6 | 153.1 | 1,820.5 | 796.0 |

[1] Additional detail appears in "Combined Statement of Receipts, Expenditures and Balances of the U.S. Government for the Fiscal Year Ended June 30, 1958." U.S. Treasury Department, Fiscal Service, Bureau of Accounts.

[2] Additional detail appears quarterly in ICA publication, Counterpart Funds and ICA Foreign Currency Accounts, ICA, Office of Statistics and Reports.

[3] Less than $50,000.

[4] Approximately ⅔ of these funds are available only for loans and grants to the purchasing country.

[5] Under the Mutual Security Act, these funds are available only for mutual security programs.

Mr. Stans. Yes.

Representative Patman. I notice you do not hold out any hope for reduction of interest payments. It has now reached over $8 billion a year.

At one time we said that we were going to have low interest payments for the people who furnished the money to fight the wars. And we were going to have low wages for the people who entered the military service. That was particularly true in World War I, and there was a lot of talk about it in World War II. But now we find that the cost of winning these wars that is now a part of our national debt—the cost of that has increased the carrying charges from 50 to 60 percent; whereas, the cost of the veterans of all wars and for all purposes in connection with those wars remains approximately the same.

I am not saying that we should keep them in balance or in proportion. It is right interesting to notice that that old understanding that we first had in World War I is being cast aside.

Do you know of any agency of our Government that is making any study for the purpose of trying to save interest on the carrying of our national debt?

Mr. STANS. I would like to say first, Mr. Patman, that some of the increase in the amount of the interest expenditure in the 1960 budget is, of course, due to the increase in the total size of the national debt, while some of it, of course——

Representative PATMAN. Of course that is true——

Mr. STANS. Is due to the increase in interest rates.

Representative PATMAN. I get your point there, and it is a good one too from your standpoint. But I think the overall increase is due largely to increases in interest rates. And I have never heard of anybody making any study or taking any action that would lead to a decrease in interest rates. And I think it is terrible, that here in our country, just a few days ago the 4-percent rate on Government bonds was broken for the first time, I guess, in 25 years. That looks like that you are shooting for a 4½ percent interest rate on Government bonds. What is your opinion about that? Do you think we will go to 4½ percent interest on Government bonds, Mr. Stans?

Mr. STANS. I would like to say this, if I may. The Secretary of the Treasury is of course responsible for debt management. And I understand that he is going to be before this committee next week. I think it would be much more effective for the committee if the question of the debt management and interest rates was addressed to him rather than to me.

Representative PATMAN. I will be very glad to do that.

Of course he is more or less a captive of the "independent" Federal Reserve Board which has declared its independence and seceded from the Government. I am apprehensive of the Treasury being persuaded by our good friends in the New York banks who have been running our country too long on interest rates. But I wish something could be done in the way of decreasing the interest rate. I think that is one place where you can really make a reduction.

In the event the Congress should pass an expenditure budget in excess of the budget recommended by the President and the choice would be either a deficit or increased taxes, which would you recommend?

Mr. STANS. I think it would depend to some extent on the size of the deficit that was involved. If it were relatively small, I am sure that I would not want to see further tax increases. If it is one that is significant, I think we would probably have to face up to the question of tax increases.

Representative PATMAN. In that case you would recommend tax increases?

Mr. STANS. Well, if it were of sufficient size, yes, I think we would have to. I think it is not a good idea for the Government to operate continuously at deficits as a matter of deliberate policy.

Representative PATMAN. Don't you think that we should have some planned program for the reduction of the national debt? Don't you think it really stands in the way of the progress of the country that every time that we have proposed spending money of any sizable amount they say, oh, it will cause inflation, all because the national debt is to big. Don't you think it is in the interest of our country that we substantially reduce that national debt as quickly as possible so as to encourage progress in the country?

Mr. STANS. I do. I agree with the gentleman. I would like to say just this with respect to the 1960 budget, however. That we have moved or we will have moved from a deficit of almost $13 billion in fiscal 1959 to a balance in 1960 if the Congress adopts this budget.

Looking ahead to 1961 and subsequent years, with a continuation of prosperous conditions in the country, I certainly think that a part of the tax collections should be used for gradual reduction of the national debt.

Representative PATMAN. Don't you think we should have a better coordinated planned program that leads to the reduction, a planned reduction of the national debt? You never hear anything about it. Nobody advocates it. It seems like it is because it is so profitable to somebody to have a large national debt outstanding upon which interest is paid. The interest rates are so high that we have opposition of certain people to paying the national debt; whereas, if the interest rates were lower, there would be more support for the reduction of the debt. Don't you think that enters into it?

Mr. STANS. I think it does. I think the fact that enters into this question more than anything else is the urge on the part of the people of the country to have the Federal Government increase its level of spending.

So long as these pressures continue as they exist at the present time—and some of them perhaps are matters that we can't do much about, particularly in the military area—these high levels of expenditures are going to encroach so closely upon the potential tax collections that it is going to be very difficult to get debt reductions.

Representative PATMAN. Mr. Stans, do you recognize this one fact? That the Federal Reserve can fix the interest rate where it wants to keep it there, whether it is 2 percent or 2½ percent? Do you concede that is possible?

Mr. STANS. Certainly by fixing the rediscount rate it has an effect upon it.

Representative PATMAN. And the open market purchases and the reserve requirements and the many weapons that they have.

Mr. STANS. Yes.

Representative PATMAN. In other words the interest rate has gone up because the Federal Reserve and the Treasury were willing for the interest rate to go up?

In other words, they wanted it to go up? If they didn't want it to go up, it could stay the same or go down?

Mr. STANS. I should think, sir, that the Secretary of the Treasury would want to comment on that and on your earlier questions.

Representative PATMAN. I will not insist.

Mr. STANS. Thank you.

The CHAIRMAN. Congressman Curtis.

Representative CURTIS. Thank you, Mr. Chairman.

As I understand the theory of this budget—and I think this is a basic political theory—that if we are not going to balance the budgets in years that are prosperous years, the whole theory of those who advocate deficit financing is going to fall down. Am I not correct?

Mr. STANS. I think our feeling is just about that; that if we can't balance our budget in a year like 1960 when conditions are expected to be really prosperous, then, the possibility of debt reduction, of tax reduction, and of less government, becomes very, very remote.

Representative CURTIS. Well, you have advocated deficit financing in previous budgets. Or we have, I should say.

Mr. STANS. Those have been previous budgets that have suggested a deficit financing.

Representative CURTIS. That was on the theory, was it not—that is what I am getting to because this is theory—that was on the theory that we would recoup in prosperous years.

Mr. STANS. Well, I know that theory is generally advanced, that when we have a year of emergency, such as war or a recession, that we should recoup in prosperous years. I think the theory is more observed in the breach, however.

Representative CURTIS. Well, that is the reason I raised the point, the theory has broken down in practice often, and it looks like it may break down again in the present budget; certainly if we don't adhere to the budget proposed here, which is balanced, and based upon prosperous years, it would be my observation that those who advocate deficit financing can nevermore be heard on their theory.

Mr. STANS. I would hope so.

Representative CURTIS. Yes. Now, I am very much interested in these items that lie outside I guess you would call it, the legislative budget.

But I notice that you anticipate more revenue from additional user charges. And some of them are spelled out in the President's message. I presume increased postal rates could be regarded as a user charge. Are there any others that might be mentioned? I don't want to bring in at this time the trust fund increases.

Mr. STANS. Well, the budget proposes a $350 million increase in postal rates as one of the elements in the category of user charges. This would put the Post Office Department on a basis of paying its way, except for a remaining appropriation of $172 million that the general taxpayer would still bear for the cost of public services identified by the Congress in the Postal Act of 1958. And I may say that in the Postal Policy Act of 1958 there is a definite expression of the policy of the Congress that the Post Office should pay its way.

Now, in addition to an increase in postal rates, there is a proposal that the tax on aviation gasoline be increased and a similar tax be levied on other aviation fuels.

Representative CURTIS. Yes. Well, I am going to come to those where there is an actual addition. Well, that would be more in the nature of a user charge, although I don't want to get to trust funds yet.

Mr. STANS. This, sir, would not be a trust fund. This would go into the general receipts of the Government.

Representative CURTIS. Oh, it wouldn't be earmarked for airports.

Mr. STANS. No. It would be a relatively small portion of the cost of our airport construction and operation program and would go into the regular receipts of the Treasury.

Representative CURTIS. But it does represent an effort to pass on some of the additional costs of expanding our airports on the users of the airports; is that the theory?

Mr. STANS. Yes, of expanding the whole airways system of regulation, control, and operation.

Representative CURTIS. Yes. Now, just to try and get this straight in my mind. On page 14 of your 1960 Federal Budget in Brief. And then you have an item, the fourth item, "All other receipts"; and your estimates go from $5.7 to $5.6 and then to $6 billion.

Would that item include that kind of user charge?

Well, let me ask the first question: Would that include increased postal rates, for example?

Mr. STANS. No, sir. Increase in postal rates would be applied directly against the expenses of the Post Office Department.

Representative CURTIS. That is what I thought.

Now, isn't it true that there are many, many user charges in the Government aside from postal rates?

Well, of course we have the situation—the Exchange Commission comes to my mind in regard to the question of whether or not user rates should bear more of the costs there. But throughout the Government we have a lot of these user charges. Has the Bureau ever gotten all of those charges together and taken a look at them?

Mr. STANS. Yes. There are hundreds of them. I don't know the precise total. But the Bureau has had a project underway for some time to study the extent of the charges, the extent to which they cover the cost of rendering the special service, and the possibility of applying new user charges.

Representative CURTIS. Is some of the increased receipts to come from that area?

Mr. STANS. A very small amount.

Representative CURTIS. Incidentally, on that, I imagine we need some new legislation; but isn't there some leeway in the executive department to increase some of those charges without reference to the Congress?

Mr. STANS. There is administrative leeway on user charges in a considerable number of areas. But there are also legislative restrictions against the application of user charges in some cases, and many of them would require specific authorizing legislation.

We have, for example, where administrative action was possible in the last year or two, urged the agencies to increase their charges to reflect such things as increased pay of employees. The amount of user charges which is reflected in revenues for the fiscal year 1960 in the budget is only $100 million in total of new user charges that require legislative action.

Representative CURTIS. I see. The $100 million would require legislative action. What would be the amount of increase that can be done under administrative leeway?

Mr. STANS. We have no estimate of that. No figure has been added to the budget for that. It is generally relatively small in terms of the size of the budget. It is a matter of a small amount of increases here and there over a great many places.

Representative CURTIS. Now, the next item: I notice that you are anticipating—I presume it would be in the area of increased revenues from more adequate interest rates. Is that reflected in budget receipts anywhere? Or is that outside of that little chart on page 14?

Mr. STANS. It is not reflected in budget receipts.

Representative CURTIS. It is simply by cutting down in the expenditure area; is that correct?

Mr. STANS. The expectation is that if the Federal Government receives more adequate interest rates that there will be increased opportunities for private capital to take over the burden of some of the Government's loan programs and thereby reduce the level of Federal expenditures.

Representative CURTIS. Reduce the level in the expenditure area?

Mr. STANS. That is correct.

Representative CURTIS. Yes. Now, of course, in the trust funds, there it is increased earmarked taxes that would produce your additional revenue.

Now, one item that you didn't give a figure on is the sale of property, of surplus property. And I presume the same would go if the Federal Government were to go out of certain businesses, like when they sold the Federal Barge Lines. How much revenue is anticipated in that area? How much does that amount to?

Mr. STANS. There has been no amount added to the budget revenues in anticipation of legislation which would make possible increased sales of property.

Representative CURTIS. Is it a sizable amount?

Mr. STANS. I would assume that considering the time factors involved it would not be a sizable amount in fiscal 1960. It could be larger in subsequent years.

Representative CURTIS. I put in the Congressional Record last year item itemization; but it referred to the documents of lists of Government surplus property.

I believe the amount generated annually is around $3 or $4 billion, if my memory is correct. And I computed that we were roughly receiving about 8 cents on the dollar. So that there is an indication that we are not talking from a receipt standpoint as a great deal; but I am wondering whether or not a further study in this area might bring in some sizable revenues.

Mr. STANS. Well, I think the low percentage factor that the gentleman mentions applies particularly to sales of surplus personal property other than real estate.

Representative CURTIS. That is correct.

Mr. STANS. Some of which is in the military area and has limited usefulness. In the case of surplus real estate, the return is considerably higher percentagewise. I may say that the only expectation in the budget for 1960 is for normal sales of both real estate and personal property, consistent with previous years.

Representative CURTIS. About what is that in the budget? How much in terms of millions of dollars?

Mr. STANS. $158 million in 1960 from the sale of surplus Government property.

Representative CURTIS. Now I just want to make this observation because I think this is a great area for further study, aside from the standpoint of getting more receipts; but also from the standpoint of checking the efficiency of our governmental operations.

The old mess sergeant, you know, goes to the garbage pail to find out how good his operation has been. And I suggest that a review of the items in this surplus does not indicate that they are peculiar military item. The bulk of them would be common-use items. And it is simply overbuying and improper usage that creates and generates these tremendous surpluses.

Have you got the figure, incidentally, of the total annual rate? Am I right? Is it about $3 to $4 billion in acquired cost, cost of acquisition?

Mr. STANS. I think the acquisition cost of excess personal property generated in 1957 was as high as $3 to $4 billion. The surplus property sold in 1958 was valued at about $2 billion at its cost to the Government. The comparable figure for 1956 and 1957 was between $1 and $1½ billion. That doesn't mean that the proceeds are anything of that character.

Representative CURTIS. No; I mean the cost of acquisition.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator O'Mahoney.

Senator O'MAHONEY. Mr. Chairman, I am sorry I haven't had an opportunity to listen to Mr. Stans' presentation this morning. And I will be content to ask a few simple questions. Later on I may have more to ask.

You are aware of the statements that Mr. Khrushchev has been making to the Soviet Assembly about the development of natural resources and the conservation of water; are you not?

Mr. STANS. I am aware only of what I read in the press, if you are referring to his recent speech.

Senator O'MAHONEY. Have you been aware of the statements made by Mr. Allen Dulles, a member of the administration, in testimony given by General Itschner, the head of the Army Engineers to a joint hearing of the Senate Committee on Public Works?

Have you taken these statements of the Executive into consideration in the preparation of the budget?

Mr. STANS. I am sorry, but I am not aware of any recent testimony by General Itschner. I have not had the opportunity of reading it.

Senator O'MAHONEY. Well, let me point out to you that on page M-60 of the President's message on resources, I find this statement:

> Work on many resource development projects underway was accelerated in the latter part of the fiscal year 1958 to aid in economic recovery and the higher rate of construction has continued into 1959. Carrying forward the projects started in 1959 and earlier years will require some increases in appropriations for 1960. In view of this record program, no funds are provided in the 1960 budget for starting construction of new water resources projects.
>
> Further, the budget contemplates stretching out the construction on some projects underway where this can be done without stopping work on the project.
>
> Other programs will be continued at or below current levels. Even with these economies, total expenditures for 1960 for resources programs will remain at a record level.

I note in the budget that it is pointed out that proposed expenditures for stockpiling are down. That is true; is it not?

Mr. STANS. Yes; that is correct. The stockpile is coming closer to achieving its objectives.

Senator O'MAHONEY. That is one of the ways in which those who prepared the budget are proposing to economize, by reducing the appropriations for the stockpile?

Are we in agreement?

Mr. STANS. I wouldn't say that that was a deliberate action in that respect.

Senator O'MAHONEY. What do you mean "not deliberate"?

Wasn't this whole budget preparation a deliberate act?

Mr. STANS. Certainly. But I am answering the gentleman's statement that there was a deliberate effort to reduce the stockpile expenditures. The expenditures in the budget are those which the agency in charge of the stockpile believes are necessary and adequate to meet the attainment of the stockpile objectives over a reasonable period of time.

Senator O'MAHONEY. Well, did you have any special theory upon which you acted to reduce expenditures so as to balance the budget?

Mr. STANS. There were quite a number of theories that we worked against, sir.

Senator O'MAHONEY. Mention some of them, if you will.

Mr. STANS. One was—and I think this is pretty basic—that before we could make any efforts at balancing the budget, we had to determine the level of the military needs and the needs for the Nation's security. That came first in order of importance.

Once that was achieved, it was determined that it would be possible principally by restraining the growth of programs to balance the budget level of revenues that we could expect to receive.

As I pointed out in my opening statement, which the gentleman unfortunately missed, the real budgetary action here was not significantly to reduce the level of the programs of the Government, it was to restrain increases; to restrain the growth of these programs to the point at which we could bring our expenditures and our revenues in balance.

Senator O'MAHONEY. Well, now, what was the reason for adopting this program, which I call deliberate program, of saying that there would be no new starts of water conservation projects?

Mr. STANS. The reason was this, sir:

Last year, under the influence of the recession, actions were taken to increase the level of expenditures on water resources; and the Congress authorized a considerable number of new starts. Those will all get underway either in fiscal 1959 or fiscal 1960.

Senator O'MAHONEY. Well, I am mindful of the struggle that some of us representing the Upper Colorado River Basin had with your predecessor to make certain that appropriations were made to continue the development, or to initiate the development on the Colorado River. It was done with great reluctance by your predecessor, but it was finally done.

That brings me to the point that I was seeking to emphasize: that we seem to be following a policy exemplified by the State Department of holding back resources while Soviet Russia is concentrating upon resources.

Mr. STANS. I would like to make it clear that we are not holding back on resource development.

Actually the amounts expended for water resource public works projects in 1960 will be at the highest level they have ever been in the history of the country. And in 1961, they will be greater even without any starts. And in 1962, they will be greater again, even though there were no new starts in the meantime.

Senator O'MAHONEY. Well, sir, if Soviet Russia is concentrating, as Mr. Allen Dulles says, on a drive to increase the utilization of the water that is running to waste in Russia and in Siberia, and we are stopping conservation of that water, doesn't that bring about a rather surprising situation?

Mr. STANS. Senator, I dislike very much differing with you on this; but I don't believe we are stopping the conservation of water. Of course, I am not familiar with what the Soviets are doing. But I am sure the gentleman will agree that they started out very much behind us; and perhaps they have much more to do, too.

Senator O'MAHONEY. Oh, there is no doubt about that. But isn't it known to the Bureau of the Budget that we are engaged in a cold war with Soviet Russia?

Mr. STANS. Certainly it is.

Senator O'MAHONEY. An economic war?

Mr. STANS. Certainly it is.

Senator O'MAHONEY. Isn't it known to the Bureau of the Budget that the interest on the national debt for 1960 will be greater than ever before?

Mr. STANS. Yes, it is.

Senator O'MAHONEY. Isn't it known to the Bureau of the Budget that the public debt as set forth in the budget for 1960 will be higher than ever before?

Mr. STANS. Yes. And it will require an increase in the debt ceiling again.

Senator O'MAHONEY. Well, if it be true, as you have just said, that the public debt is getting greater, that the interest on the public debt is getting greater, that we are finding it more difficult to balance the budget, doesn't it follow that we ought to have a policy that would direct the expenditure of budgetary funds to the development of new opportunities to increase production and increase the receipts of domestic industry?

Mr. STANS. I think, Senator, that is a perfectly logical suggestion. And I think it is reflected in this budget. I would like to assure you that the Bureau of the Budget is not against everything. It is not against the development of water resources.

But I think this is one of the areas in which we are forced to maintain a sense of proportion and a sense of perspective. And since there are limitations on the amount of our revenues and on the amount we can spend, it seems reasonable, with this program at the highest level in its history, not to add beyond that at this time.

Senator O'MAHONEY. Well, that being true, assuming that to be true, let me ask you what your explanation is of the proposal in the budget to increase the appropriation for the Development Loan Fund for fiscal 1959 by $225 million where Congress last year cut the appropriation down to $400 million?

Mr. STANS. Senator, I believe that in the conference report on the mutual security legislation last year there was reference to the possible need of the agency for additional money for this program and an invitation to the agency to resubmit its request in the form of a supplemental after the beginning of the session of the Congress. I don't know the precise words in which that appeared. But that is my recollection of that committee's suggestion.

Senator O'MAHONEY. I regret that the chairman has passed word that my time has been exceeded. But I want to call your attention to one aspect of this Development Loan Fund.

I have in my hand a document dated August 1958 entitled "Accumulation and Administration of Local Currencies: A Special Report by James A. Smith, Jr., International Cooperation Administration."

Opposite page 73 there begins a table entitled "Status of local currencies owned by the United States or jointly controlled by the United States and other countries."

This table shows the dollar equivalents of these local currencies. That is to say, the value of the local currencies which we now own as a result of the development fund is stated in terms of what are said to be equivalent dollars.

This shows that at the end of December 1957 this amounted to $2,046,137,000, plus an additional sum of $239.9 million, which should be added, according to this note.

What does the Budget Bureau think the United States can do with these equivalent dollars in foreign currencies which are received by us in exchange for the Treasury dollars which Congress appropriates out of the Treasury?

How are we going to spend them?

Can we cut the national debt? Can we pay any bonds or any notes?

Mr. STANS. I wish I could answer in the affirmative. But I doubt very much whether that is the case. Most of these local currencies, particularly those generated under Public Law 480, are covered by agreements which provide for their use within the country represented by the currency.

Senator O'MAHONEY. But they are not being used there because that would cause inflation there.

Mr. STANS. Well, they are not being used, to a certain extent, because we don't have uses within many of these countries to the extent of the currency that we have.

Senator O'MAHONEY. Have you any suggestion that could be made to Congress for constructive utilization of these foreign currencies which we have obtained in many instances by the development of natural resources abroad while we hold back at home?

Mr. STANS. There are a number of suggestions as to what should be done with these currencies.

Senator O'MAHONEY. I would be glad to receive them.

I don't mean at the moment.

Mr. STANS. Suppose I put a statement in the record to that effect?

Senator O'MAHONEY. If you will do that.

Mr. STANS. I will be happy to.

(The statement referred to is as follows:)

POSSIBLE USES OF FOREIGN CURRENCIES CONTROLLED BY THE UNITED STATES

As indicated in the table inserted on page 51 above, the U.S. Treasury held on June 30, 1958, a total of $1,820.5 million worth of foreign currencies in accounts overseas. In addition, there were in special counterpart accounts of foreign governments $796 million equivalents of foreign currencies which may be used only with the concurrence of the United States. By legislative action of the Congress and by the terms of international agreements, there are limitations on the purposes for which many of these currencies may be used.

A number of these currencies may be and are used in substitution for dollar expenditures for the direct benefit of U.S. programs. Virtually all of the

$153.1 million derived from other sources is used in this fashion as is at least 10 percent and usually more of the sales proceeds under Public Law 480. These currencies are sold by the Treasury to agency appropriations for use in carrying out regular U.S. operations overseas, including the acquisition of office and residence buildings by the Foreign Buildings Office, the construction and maintenance of overseas military bases, and the educational exchange program.

In addition to Treasury sale, section 104 of Public Law 480 also authorizes the use of sales proceeds for a number of additional U.S. programs which may supplement those covered by regular appropriations to agencies. In some instances, these supplementary uses are not subject to congressional control. In others they are subject to authorization through the appropriations process. These uses include the development of agricultural markets overseas, the purchase of material for a supplemental stockpile, educational exchange, and assistance to American-sponsored educational institutions, financing of trade fair and agricultural fair activities, the acquisition of buildings, scientific and cultural information, and other scientific activities.

The $796 million of special counterpart funds and also the $318.6 million of sales proceeds of surplus agricultural commodities under section 402 of the Mutual Security Act derive from the sale of commodities whose shipment abroad was financed by the mutual security appropriation. They may be used for the purposes of that appropriation as agreed between the ICA and the government of the assisted country. These funds are generally used for defense costs or economic investment within the country but some of the section 402 funds are used for the purchase of exports for shipment to third countries within the framework of mutual security assistance. The existence of substantial balances of such funds has been a normal aspect of foreign assistance operations because of inflationary pressures within foreign countries and also because of the timelag that is inherent in administering public funds for particular investment projects.

Roughly two-thirds of the $1,348.8 million worth of Public Law 480 sales proceeds may, however, be used, under the terms of the sales agreements, only for economic development or mutual defense loans or grants to the purchasing country. In the case of many underdeveloped countries, this portion of the sales proceeds is relatively large. In the case of more advanced countries which qualify for the purchase of surplus commodities in addition to their usual dollar purchases, this proportion is smaller.

The administration is actively concerned with the numerous and complicated problems which relate to these foreign currencies and to make the best use of them in the overall interest of the Government. Some of these currencies might be used as a part of the U.S. contribution to an International Development Association such as has been proposed by Senator Monroney or to establish jointly controlled foundations for these or similar purposes such as is suggested in the special report to the Director of the ICA.

Proposals for improving the control and the use of these currencies are now in development within the administration and will be submitted to this Congress at a later date. This was mentioned by the President in his budget message where he said:

"Another problem in budgetary control has developed over the use of foreign currencies. In view of the volume of currencies generated by transactions under the Agricultural Trade Development and Assistance Act of 1954 and the numerous competing demands for their use for supplementary U.S. programs, more adequate procedures parallel to those governing dollar obligations are necessary. The action required by the Congress to authorize the use of certain of these currencies, for which a supplemental request will be transmitted for fiscal 1960, now relates to only a small portion of the currencies which will actually be used for Government programs."

The CHAIRMAN. Congressman Kilburn.

Representative KILBURN. Thank you, Mr. Chairman.

First of all, Mr. Stans, the budget is so big and so staggering that it bewilders me how anyone can get up a budget like this. And I want to compliment you, sir, and your staff for the fine job you are doing for our country.

Mr. STANS. Thank you, sir.

Representative KILBURN. We have heard some here this morning, and we have heard a lot on the floor of the House about balancing the budget. Now, I am probably old fashioned, and just a country boy; but haven't you got to cut your expenditures or raise your revenues in order to balance the budget?

Mr. STANS. I don't know of any other way in which to do it.

Representative KILBURN. All the politics in the world doesn't make any difference with that fact, does it?

Mr. STANS. That is correct.

Representative KILBURN. Now, if the same people who say we want to have a policy of balancing the budget also vote for huge additional expenditures, how are you going to balance the budget?

Mr. STANS. Well, it makes it almost impossible under those conditions.

Representative KILBURN. Or if they refuse to vote additional revenue or taxes?

Mr. STANS. Yes.

Representative KILBURN. Isn't that right?

Mr. STANS. That is correct.

Representative KILBURN. So that our policy, it seems, boils right down to the fact that the Congress has got to cut expenditures or raise revenues in order to balance the budget.

Mr. STANS. Well, within the framework of the fiscal year 1960, the Budget suggests how that might be done on both counts, how the expenditures might be held to a level of $77 billion, and how with some new laws on the part of the Congress dealing with revenues, the revenues will equal $77 billion and we will be in the black.

Representative KILBURN. I am not saying this in a partisan way at all. But the Congress, and the administration, responsible to the people, it seems have got to do a job along that line regardless of any policies or any theories or anything else. Those are the two fundamental things. Isn't that true?

Mr. STANS. That is true. And I would hope it could be done by cooperation, and it is a matter of such importance that it, I would hope, it could be done by bipartisan action.

Representative KILBURN. I hope so too.

That is all, Mr. Chairman.

The CHAIRMAN. Congressman Reuss.

Representative REUSS. Mr. Stans, I would like to explore with you the fundamental question of budget-making philosophy which you discussed with Senator O'Mahoney a moment ago. Your testimony, as I understood it, was that the Eisenhower administration's method of constructing this budget was to estimate the level of receipts at current tax rates and then after making sure that defense was provided for, to adjust the expenditures so that it balanced, or just about balanced.

I am sure that this was in fact the method followed, because my understanding is that departmental requests were on the order of $85 billion for budget expenditures.

And they were obviously cut by the President to the request of $77 billion. Certainly the $8 billion that fell by the wayside was not all frivolous; parts of it, at least. I am thinking now of the Development Loan Fund allocation that had been characterized by such people as the President, the Secretary of State and two Under Secretaries of State as vital to our national posture.

Yet that Development Loan Fund request was cut.

My question to you is this: Wouldn't it be a better budget-making philosophy and one more in accord with the Employment Act of 1946 for you, instead of looking just at the receipts side and then cutting your cloth to fit the receipts, to look at the proper amount and character of expenditures needed for the various purposes which led to the departmental requests in the first place, and then, to consider along with that, the raising of the necessary revenue?

Specifically, if I may say so, wouldn't it have been a better budget, and a budget more in accord with the Employment Act of 1946, had you asked for $79 billion worth of expenditures—$2 billion more than you have in fact asked for—taken the most imperative of the $8 billion that fell by the wayside, and raised $2 billion worth of additional revenue by plugging tax loopholes?

Wouldn't that have achieved not only a better economic balance, greater growth, a diminution in the present unemployment and underuse of resources, but as a result of the increased economic activity induced by this extra $2 billion of expenditures, wouldn't it have actually permitted a greater tax yield from existing resources and thus have enabled you, on your figures at least, to envisage a surplus for the coming year?

Mr. STANS. Congressman, I would like to say this: That is a rather involved question. I will have to deal with it in its various parts. First of all I would like to make the point that the process I described to you of providing first for the national defense out of revenues and then for other things after we know the revenue figure was not one in chronological order. It was a concurrent operation, of course.

And I don't mean to imply that we did one thing and then went on to the next.

Now, with respect to the requests of the agencies of the Government, I think we all have to recognize some factors. The head of every department and agency of the Government believes in his program, believes in the work of his agency. He should believe in those programs or he shouldn't be there. It is always possible for the head of an agency to conceive of ways of doing his job better.

And it is not inconsistent with responsibility to suggest to the President that if he had additional amounts of money that he could do certain things that he can't now do.

Now, the process of review of the budget is to take a look at all of those suggestions. Preparing a budget is a responsibility that involves consideration of priorities, among a great many things. The Bureau of the Budget looked very carefully at every suggestion for spending in this budget and believes that the amounts that are included in the budget are adequate and ample to carry out the programs of each agency; certainly not to the extent that the heads of the agencies might have wanted to, but certainly enough to carry them ahead, particularly since in practically all of the agencies the amounts of money recomemnded in this budget exceed the amounts that have been enacted and made available to them for 1959.

Representative REUSS. Let me ask you this question, sir.

Suppose your revenue receipts estimates, instead of being the $77 billion which they in fact are, had been $75 billion, would your recommended expenditures have been $75 billion or $77 billion?

Mr. STANS. Well, it is a little bit hard to answer that with certainty. My own belief is that the expenditures would have been about at the present level, and that with receipts of $75 billion we would have had to face up to the possibility of a deficit, and determine whether we were going to finance that deficit by further borrowing or by tax increases.

Representative REUSS. That sounds a little inconsistent with what you have said hitherto about figuring out the receipts and then endeavoring to get the expenditures to jibe with the receipts.

Mr. STANS. Well I didn't mean to imply that it was that ironclad a decision.

The level of the receipts had a great deal to do with the possibilities of balancing the budget. And it was after the economists and the Treasury Department and others had reached a conclusion that we could expect receipts in the general range of $77 billion that we were able to plan the budget to hold the expenditures at that level. If they had come up with $75 billion, I think it would have been almost impossible to present a budget balanced on that basis, because then it would have meant we would have to cut substantially either the military program or some of the civilian programs. And that didn't seem to be consistent with the administration's policies through the years.

Representative REUSS. And it is your testimony that your actual budget, the $77-billion in-and-out balanced budget, is a budget more in accord with the Employment Act of 1946 and with the needs of the economy than the one I have put to you, namely, balanced budget of $79 billion obtained by adding $2 billion of the most imperative needs and repairing the gap by plugging $2 billion worth of tax loopholes?

Mr. STANS. Well, of course I could answer that question better if I knew what the gentleman had in mind in the extra $2 billion he is discussing.

Representative REUSS. Let me say on that: You can take any assumption you want. But one way of getting an additional $2 billion, according to the information I have received today from the Joint Committee on Internal Revenue Taxation, would be to plug such loopholes as the minerals-depletion allowance, and the special treatment for dividends in the 1954 act, and by requiring withholding at the source of dividends and adjustment of the present entertainment allowance in business deductions. That is one way you could raise $2 billion.

Mr. STANS. What I really meant was how the gentleman proposed to spend the $2 billion.

Representative REUSS. I left that to you. But let's say, spend the additional $300 million on the development loan fund that the President said was imperative if we are to survive; spend something, at least, on area development so as to assist these areas of unemployment throughout the country; spend some more on national defense; and so on.

I will leave it to you to take the $8 billion of excess budget requests and come up with the $2 billion most imperative.

Mr. STANS. I am sure the gentleman realizes there is something in this budget for the area assistance program.

I would find it extremely difficult offhand to weigh the effect on the employment level of the country of a $2 billion increase in expenditures and a $2 billion increase in tax take.

Representative REUSS. I see my time is up, Mr. Stans. I would appreciate it if before these hearings conclude you would read the colloquy that has just taken place between us and see if you can't prepare for the record an answer to the question I put with special relation to the budgetmaking philosophy which is involved.

Mr. STANS. I will be happy to do that. And beyond that I was about to suggest the persons more qualified in that area are members of the Council of Economic Advisers whose responsibility it is to implement the full Employment Act.

Representative REUSS. Well, you have a responsibility under that act, too.

Mr. STANS. Yes; I do.

(Mr. Stans supplied the following statement for the record:)

It is impossible to give a meaningful answer in the abstract to the question of whether a balanced budget of $79 billion would be "more in accord with the Employment Act of 1946 and with the needs of the economy" than the budget presented by the President, which balanced receipts and expenditures at $77 billion. Certainly, it is the view of the administration that the 1960 budget as transmitted to the Congress is in accord with the objectives of the Employment Act of 1946 and, if accepted and approved by the Congress, would meet the needs of the economy as we now see them.

In order to determine the impact of a larger balanced budget on the economy and its bearing on the implementation of the objectives of the Employment Act of 1946, one would have to evaluate the effect of the specific additional expenditure proposals which would be involved, together with the effect of the additional tax measures which would be required. I understand that economists themselves differ about the net effect of an increase in Government expenditures financed by taxes, and express the view that the effect would be different at different times and under different conditions.

If one were to accept the rather widely held view that an increase in Government expenditures—even though matched by a corresponding increase in revenues—tends to increase total demands on the economy and thus be expansionary, the suggested larger budget would aggravate the problem of maintaining price stability. The administration believes that the period covered by the 1960 budget will be a prosperous period of high employment and income with Federal spending held to the $77 billion level. Hence, a budget more expansionary than this would increase inflationary pressures in the economy.

With regard to how the additional revenue could be raised, it will be appreciated that there is some disagreement as to whether the specific measures suggested would close "loopholes." Actually, they would have economic effects as well. Nevertheless, questions of equity and fairness in the treatment of different taxpayers are important and should be considered in addition to questions of their economic effects.

There can be little doubt that an increase of taxes by as much as $2 billion affecting a relatively small group of taxpayers would have significant adverse effect on incentives to investment and on risk taking, thereby inhibiting production. Furthermore, there is some doubt whether the specific revenue measures which are being suggested would produce as much as $2 billion in the first year of enactment. Hence it would seem difficult, if not impossible, to raise so large an amount without increasing the already heavy burden of Federal taxes on the general taxpayers. This needs to be taken into account in evaluating the desirability of the additional expenditures which this revenue would finance.

Representative REUSS. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Reuss.

Mr. Stans, I want to direct my questions primarily to the field of expenditures of the Department of Defense.

Let me say that I do not think that the budget for the Department of Defense should be further reduced. I think you have made your cuts in the wrong places and have not pushed for economies which could be realized. I think the cut in fighting strength of the Army and Marine Corps reduces our capacity for limited warfare. I think the evidence is pretty clear we should spend more for missiles. But those matters are beside the point.

I would like to call your attention, if I may, to what seemed to me to be shockingly excessive quantities of supplies which are in stock in the Department of Defense. I have here a report of the House Committee on Government Operations. And on page 100 it shows that the supply system inventories of the Department of Defense as of last June 30 amounted to $46,600 million.

That undistributed stocks were $2.4 billion; leaving distributed stocks at $44.1 billion. That the peacetime operating reserve was set at $14.5 billion. The mobilization reserve was $12.1 billion. Thus the large reserves both for peace and for war—and a long war at that—came to $26.6 billion this leaves supplies in inventories of $17.5 billion in excess of needed peacetime and wartime reserves.

Now, it is admitted by the Department of Defense that the excess stocks alone amounted to $10.4 billion. Then there are two other categories that certainly seem to me to fall in the line of excess stocks. Economic retention of $5.6 billion, and a contingency retention of $1 billion.

This is following out a question that Congressman Curtis raised at conclusion.

What should be done is to draw down these reserve stocks for current use and diminish the volume of purchases and then use the money thus saved to provide more combat strength for the Army and the Marine Corps and for more missile strength for the Nation.

I would like to have your comments on that.

If you do not have that copy of that bulletin, I will be glad to give it to you. It is on page 100.

Mr. STANS. Mr. Chairman, I had the opportunity of reading a good bit of this report over the last weekend. And I found it very interesting, as you did. And I have instituted some analyses of the underlying information in order to determine what the Bureau of the Budget can do to help in solving the problem that it portrays.

I think there are some things that probably are inherent in this situation. One is that I am sure the stocks of inventories in the Department of Defense still reflect to a large extent the Korean and early post-Korean procurement. Secondly, I am convinced from my own knowledge that this type of information in defense is a result of tremendous improvements in their accounting processes that have taken place in the last few years.

Some few years ago it may not have been able to develop this kind of information.

The CHAIRMAN. I may say these improvements have been the result of persistent pressures of Members of the House and Senate against the opposition of the Department of Defense and the administration.

Representative CURTIS. All administrations, Senator.

The CHAIRMAN. I think that is correct.

Mr. STANS. Beyond that I think also we have to recognize that obsolescence is almost a normal function in defense. The development of new weapons assumes that old weapons will become obsolete.

The CHAIRMAN. Yes. But, Mr. Stans, a large portion of this is not in obsolete weapons, but in clothing, food, communications equipment, general supplies, repair parts and so forth, which could be used for peacetime training purposes.

In peacetime training you don't have to have the most advanced equipment.

Mr. STANS. I understand some of the facts the Senator mentions. And they are in this report. I know that the Department of Defense has a very substantial program to step up the disposal of surplus and to use usable equipment. I don't know what proportion of this inventory is involved in that program. All I can assure you is that since this report came out, it has become quite interesting to us, and we intend to look into the matter with the Department of Defense.

The CHAIRMAN. I may say it is the intention of the Senator from Illinois to propose, when the Defense Department bill comes before the Senate, reductions in items calling for purchase of new supplies and a transfer of the funds thus saved to the Army and to the Marine Corps to increase their actual fighting and combat strength and to the various branches of the armed services which have the missile program and to whom the missile program has been confined.

I will be very glad to get your cooperation rather than the resistance of the administration.

Now let me turn to another matter. That is the relative predominance of negotiated contracts over advertised bid contracts. I have here a report by the Secretary of Defense himself for the year July 1957—June 1958. On page 26 it shows that of the 5 million—and I give to the nearest hundred thousand—5,100,000 contracts awarded by the Department of Defense during the fiscal year June 1958, only 275,000 resulted from formally advertised bids—competitive bidding, in other words. Only 5 percent! But 95 percent were negotiated.

In terms of dollar volume, of the $23.7 billion, only $3.3 came from advertised or competitive bidding. $20.4 of the dollar volume of contracts let came from negotiated bids; 14 percent from competitive bids, 86 percent from negotiated bids.

Now, I may say that the Senator from Illinois and others have been hammering at this point for years, year after year after year, because negotiated bids permit agreements between suppliers to the Government and the Government procurement officers.

And they tend on the whole to result in excessive expense.

Now, granting that some of these contracts would have to be negotiated, because you wouldn't want in the case of secret weapons and so forth to publish the details to the world, nevertheless if any city government were to follow the purchasing practices of the Department of Defense they would be blasted as grossly incompetent and in league with the suppliers.

Now, I think 7 years ago the Senator from Illinois first raised this point. Nothing happened. The battle has been raised on the House side. I think the Congressman from Missouri has raised it.

Representative CURTIS. Constantly.

The CHAIRMAN. This continues year after year.

Now is there anything that we can do to force the Department of Defense to comply with decent competitive practices?

Mr. STANS. Senator, I am not wholly acquainted with the statistics you mentioned. But I recognize that the situation does exist. Obviously the Department of Defense people have this responsibility. And I think they could answer much better than I can as to the ratio.

I would like to point this out. That when it comes to purchasing an Atlas missile or any of the other modern weapons of war which involve tremendous amounts of money, I don't believe it is possible to get competitive bids.

The CHAIRMAN. My time is up.

For the sake of the newspapermen, I would like to identify the first report which lies on the table there as coming from the House Committee on Governmental Operations. And it is entitled "Federal Real and Personal Property, Inventory Report." I may say it shows total personal property holdings of the Government of $120 billion.

Now, let's try the second round of questioning. And this time I think we should limit ourselves to 5 minutes.

Representative CURTIS. Senator, I want to pick up on just one point.

I think, let's not be too satisfied when the military come back and say that the negotiated bids are necessary because of the military aspect. I was very much interested in Admiral Rickover's statement that the *Nautilus* was built almost entirely through competitive bidding. And furthermore there was no subsidies in the building of the *Nautilus*.

I think that this is an area—and I am convinced after some 9 years study as a Member of the Congress and 4 years in the Navy—that in this general area we still have not gotten to the bottom. Here is an area in which we could be saving billions and getting more adequate defense.

One item I wanted to go back to is on natural resources,. On page 26 in "The Budget in Brief" there is a very good explanation, and inasmuch as Senator O'Mahoney made some points on there, there were two things I wanted to just have developed a little further.

One, you do say that there is money in the budget to continue investigation and advance planning and to assemble basic data for future projects. So I presume that it is in the future to have new starts in water resources?

Mr. STANS. Oh, there is no thought at all of stopping permanently the development and conservation of the natural resources of the country. This is a budget policy for the year 1960.

And, as you say, there is planning money looking ahead to the development needs of the country and ways of supplying those needs.

Representative CURTIS. Now, the next item in this same thing—and this is the area I am interested in in line with my questioning: You state that you are making studies to figure out a better formula in the uniform basis of cost sharing for projects—that is, sharing with the local beneficiaries.

Do you contemplate that in this area we might be able to save money for the Federal Government and at the same time go ahead with possibly even an accelerated pace of developing our water resources?

Mr. STANS. Well, I think there are several aspects to that. One is that a uniform policy has all the advantages of uniformity. It prevents discrimination and unfairness in some cases, and it prevents other projects from going ahead without a fair share of contribution by local interest.

That is one answer.

Another answer is, of course, that if the local communities pay a fair share representing some of the value enhancement that takes place locally and the benefits they realize, it makes it possible for the Federal Government's money to go farther.

Representative CURTIS. It isn't just the local governmental communities entirely, is it? Don't we get the local beneficiaries in the private sector in some of these?

Mr. STANS. Yes, of course.

Representative CURTIS. Yes.

Now, one other area in regard to this plugging tax loopholes that Congressman Reuss mentioned.

Of course, calling it a loophole sort of begs the question in the very beginning, because some of these things to some people are not loopholes. One might say that last year when we passed this small business tax relief bill, maybe we put another loophole in. But in the budget this time, do you not include anticipated increased revenues from taxation of life insurance companies?

Mr. STANS. Yes. There are three proposals for increased taxation that perhaps come within the gentleman's definition of the term. One is to increase the taxation of life insurance companies by approximately $200 million a year. Another is to improve the method of taxation on cooperatives.

Representative CURTIS. Yes?

Mr. STANS. And a third is to clarify the intent of the Congress on taxation to the extent that it is affected by depletion allowances on cement and clay products.

Representative CURTIS. That is a rather sizable item, is it not. It is about $200 million, as I recall.

Mr. STANS. The first-year impact is relatively small because of the time involved in enactment and putting it into effect in relation to the time of collecting taxes.

We estimate that for budget purposes that the sum of the two proposals relating to cooperative activities and depletion charges is somewhere around $50 million the first year. In subsequent years it would be somewhat more.

Representative CURTIS. So there has been attention paid to this area of so-called loopholes.

Lest I give the wrong impression, let me say I do not happen to agree with the administration in regard to whether taxation of insurance companies constitutes a loophole. I think it is very, very objectionable. I might say this is a realistic proposal, so if the administration were proposing to gain additional revenues from changing our method of computing oil depletion we probably couldn't count on that very heavily with the Congress as constituted.

Mr. STANS. I think the gentleman knows that better than I do.

Representative CURTIS. Yes. I might say I join with my colleague from Wisconsin that that is an area we need to look into. I have recommended it many times. But I am a realist in politics, too, to some degree.

Representative REUSS. Would the gentleman yield?

Representative CURTIS. Sure.

Representative REUSS. I have an observation on that point. It is true, you know, that the predecessor to the present President did repeatedly, although in vain, request Congress to plug the depletion loophole.

Representative CURTIS. I doubt it inasmuch as the 81st Congress was also of the same party of the incumbent President.

So maybe that was just a Republican assumption.

Representative REUSS. I believe not.

Representative CURTIS. That is all, Mr. Chairman.

The CHAIRMAN. Congressman Patman.

Representative PATMAN. Mr. Stans, I appreciate the fact that you have a difficult job. I sympathize with you in your efforts to render the fine public service that I know you are trying to render.

I know you are trying to find all the funds that you can in order to balance the budget, if possible.

Have you considered that the Federal Reserve banks have about $1 billion of money that belongs to the people, Government money, that is unused, that is absolutely idle, that you could get if you wanted? And it will never be used, from testimony of witnesses before the committees, which have shown that this money will never be used? There is no opportunity for its use. It is not invested. It is just idle. It is just there.

Mr. STANS. I am not aware of that, Congressman.

I think that may be an area in which the Secretary of the Treasury will be much more competent than I.

Representative PATMAN. The Secretary of the Treasury wouldn't have any influence there, because the Federal Reserve has been recognized by this administration as an independent organization. In other words, a fourth branch of the Government.

The Secretary of the Treasury wouldn't have any influence over that. But I think the Director of the Bureau of the Budget, a recommendation from him that these funds be utilized, I think, would be very helpful. I am not trying to put you on the spot. But I suggest you give it consideration.

Mr. STANS. Thank you, sir. We will.

Representative PATMAN. Another thing is about these interest rates.

You know we have to meet with Russia on all these economic requests. Russia has a pattern of interest rates to these countries with whom they are dealing and advancing hundreds of millions of dollars for different purposes—dams and everything else. And that pattern is not in excess of 2½ percent interest.

Now, I never see that published anywhere in the United States. I don't think there is any effort to keep the people from knowing that Russia makes these loans at 2½ percent interest. But I have never seen that published in any magazine or newspaper in the United States.

Yet it is a known fact that Russia does not charge more than 2½ percent interest.

Now, if we continue to build up our interest rates and increase them to where we will have to charge 4, 5, and 6 percent, we won't have much chance to compete with Russia in that area. So, we are placing ourselves at a disadvantage in foreign affairs.

And I hope the Director of the Bureau of the Budget and the administration will give consideration to that in the future. Instead of doing things that will increase interest rates, efforts should be made to turn monetary and debt management policies in a way that will actully cause a reduction of interest rates, not only because of our own internal domestic problems, but also in competition with Russia in the areas in which I have mentioned. I will not take any more time, Mr. Chairman.

The CHAIRMAN. Congressman Kilburn?

Representative KILBURN. One thing, Mr. Stans, that I am not clear about in connection with the questions of our chairman about the Defense Department and negotiated contracts is this: What authority does the Bureau of the Budget have over the Defense Department, if any, to force them to make—to force them to have competitive bids?

Mr. STANS. I am not sure that there is any statutory authority. On the other hand, I think that if the Bureau of the Budget came to the conclusion that this was by any chance a costly or wasteful process, that it would be within our responsibility to advise the President of it, discuss it with the Department of Defense and see that appropriate action was taken.

I think that might come under our general budgetary responsibility, or it might even come within our responsibility for improvement of management of the Government.

I think this is a situation, however, in which the Defense people would have all of the facts with which to enter their own answers to the questions that have been raised.

The CHAIRMAN. May I point out that one of these reports, these advertised contracts, comes from the Secretary of Defense himself.

Representative KILBURN. What I wanted to get clear is this: There is an area in there, it seems, that is probably a little vague. Here the Defense Department comes to you, as I understand it, for what they want in the budget; is that correct?

Mr. STANS. That is correct.

Representative KILBURN. They must justify to you the proposed expenditures. But when it comes to the separate question of the way they are running the Department of Defense, it seems you are on a spot. I don't know how far you can go into that.

Mr. STANS. Well, obviously the Bureau of the Budget with 425 people cannot maintain surveillance over all of the activities of all of the agencies of the Federal Government. However, if something comes to our attention in the ordinary course of events, such as the case of this hearing, that suggests that Defense may be spending more money than is necessary, certainly we would undertake to have discussions with the Department of the Defense and see whether they could satisfy us that that was not the case.

And certainly I will have some discussions with the Secretary of the Defense on the subject.

This is the first time it has come to my attention as a matter of potential difference in the expenditure levels of the Department.

Representative KILBURN. Well, I can see where Senator Douglas mentioned some items there that he thought should be cut, and so on; that that would be certainly within your jurisdiction. But I am not clear whether or not it is within the jurisdiction of the Budget to tell the Secretary of Defense how he shall operate that Department. And if it is within your jurisdiction, I would like to know.

Mr. STANS. Well I think clearly it is within the President's responsibility and authority to investigate a matter of that type. And as an arm of the President dealing with the level of expenditures in the Government, I would assume that any question of authority to look into this matter could easily be clarified. And I do intend, as I said, now that the question has been raised, to discuss the matter with the Department of Defense; because certainly I have just as much interest as any member of this committee in seeing that we don't spend any more money than is necessary in the operation of the Government.

Representative KILBURN. That is all, Mr. Chairman.

The CHAIRMAN. Congressman Reuss.

Representative REUSS. Mr. Stans, at this time last year the administration's budget included an estimate of $74.4 billion in estimated revenues.

According to your figures today the actual receipts from revenues are going to be more than $6 billion under that, on the order of $68 billion.

Bear in mind the fact that just a year ago the recession was pretty close to its trough; and bear in mind further the fact that the administration has pronounced itself as agreeably surprised by the fact that the recession ended, as it puts it, a little sooner than it had expected.

In the light of this, and in the further light of the fact that your revenue estimates for the upcoming fiscal year are around $3 billion more than they were originally estimated for the present fiscal year or almost $9 billion more than the current estimate of receipts, what reassurance can you give us that your present revenue estimates aren't based on the same overoptimism that they turned out to have last year.

Mr. STANS. I would be glad to answer that because it may be very helpful in supporting this $77 billion level of revenues.

First of all may I say without wanting to be in any way in disagreement with the gentleman that I don't think the administration would agree that it was agreeably surprised at the recovery. I think that most of the members of the administration would feel that they were pleased that their confidence was vindicated by the recovery.

Representative REUSS. Presently I shall send some evidence to the contrary to the Budget Director.

Mr. STANS. Thank you.

With respect to the level of revenues there are two principal factors that I think bear on the validity of the $77 billion estimate. One is that in the recession of 1954–55 there was a similar pattern, and the recovery in revenues in fiscal 1956 over the low year of 1955 after adjusting for comparability in corporation tax payment dates was over $9 billion, and that at a time when our economy was, of course, at a somewhat lower level than today in size. So that is fact No. 1, that the recovery from the last recession supports the increased expectation of the $9 billion.

Secondly, there has been a lot of conjecture and discussion and a great deal of published material on the expectations of the recovery that will take place in fiscal 1959 and 1960. And most of that seems to center on estimates of Federal revenues ranging from a low of $75 billion to a high of $78 billion. At least I have not seen any estimates that went outside of that range on either the low side or the high side. The $77.1 billion figure in the budget is made up of two factors. A figure of $76\frac{1}{2}$ billion for the expected revenues from present tax sources and under present tax rates, and about $600 million from new tax sources and other sources of miscellaneous receipts.

Representative REUSS. By "other sources," you mean what you discussed with Mr. Curtis a moment ago?

Mr. STANS. I discussed most of them with him; yes. The fact that the revenue estimate from existing tax rates and sources does lie coincidently at the midpoint of the 75 to 78 range, I think is added support for the belief that it is a reasonable estimate.

The Secretary of the Treasury may want to comment more on this point because under the division between Treasury and Budget in preparing the annual budget, Treasury takes the lead on the revenue side in conjunction with the Council of Economic Advisers; and of course our responsibility is primarily related to the expenditure side.

Representative REUSS. Thank you very much. I certainly hope you are right on the revenue estimates.

The CHAIRMAN. Mr. Stans, in past years I have been somewhat distressed at the failure of the administration's budget to provide any expenditure for contributions by Federal agencies to the civil service retirement fund. Now claims against this continue. Failure to provide the Government's share means that this policy is inconsistent and inadequate. And the pension fund will go bankrupt. And later administrations will have to make good the past deficiencies.

Now, I have searched this budget very, very carefully and I do not find any specific items, either in the general budget or in the lists for individual departments or agencies, for contributions by the Government or by their agencies to the civil service retirement fund. Now, where is this shown in the Budget, if it is shown?

Mr. STANS. Mr. Chairman, answering your question with respect to the location of the Budget first; page 881 shows that the total contributions by the Government in fiscal year 1960 will be approximately $721 million, and the earnings of the fund on its holdings of Government securities will be approximately $224 million. Under the amendments to the Civil Service Retirement Act passed a couple of years ago, each agency of the Government is required to pay directly a contribution of $6\frac{1}{2}$ percent of the payroll, matching the deduction made from the employees' earnings.

The CHAIRMAN. Is that item entered under the various departments?

Mr. STANS. Yes.

The CHAIRMAN. Of each department?

Mr. STANS. Of each department and agency.

The CHAIRMAN. Well, where is this allocation by agency? And have they made up any—have you made up any for past deficits?

Mr. STANS. This is a current contribution that appears within the budget structure of each of the agencies.

Now, I am well aware of the fact that there is a great deal of discussion and difference of opinion as to whether or not further contributions ought to be made by the Federal Government to put the fund on an acturial basis. The position of this administration has been that that is not necessary.

The CHAIRMAN. Although it has been insisting on full reserves in the social security fund aid in the railway retirement fund.

Mr. STANS. Well, Senator, I think there is a difference in the character of these funds that you describe. The social security fund is made up by contributions from private employees and employers. There is no contribution or obligation on the part of the Federal Government for privately employed workers.

The CHAIRMAN. Excuse me, Mr. Stans. I would like to point out that in this case the Government is the employer.

Mr. STANS. That is correct.

The CHAIRMAN. And it binds itself to make equal contributions to the employees. Yet in past years it has failed to do so.

Do I understand that this year it is doing so?

Mr. STANS. The Government has never failed to make some annual contribution to this fund; to the best of my knowledge.

The CHAIRMAN. For instance, I have here the Department of Justice. Where in the Department of Justice budget is there allowance for these contributions and are the contributions adequate?

Mr. STANS. While Mr. McCandless is looking for the precise item, may I amplify my previous answer with respect to the social security fund?

The CHAIRMAN. Well, what page is this on?

The Department of Justice begins on page 749. Now just where is the item?

Mr. STANS. It is under code 11 on page 755 of the budget. In the first table that appears on the upper lefthand corner of the page "Grants, subsidies, and contributions."

That is in the amount of $1,706,000 for 1960. And that includes the contribution of the Department of Justice to the civil service retirement fund.

The CHAIRMAN. Well, that is certainly an ambiguous entry, "Grants, contributions, and subsidies."

Is that the uniform way in which these contributions are covered up throughout the Department? Is that the uniform classification?

Mr. STANS. That is the uniform classification. It is not for any purpose of coverup. Because the total figure is shown, as I said, later on in the budget.

The CHAIRMAN. Well, is that 6½ percent on the payment for personal services that the Department charges?

Mr. STANS. To the extent that the employees are covered under the Retirement Act.

The CHAIRMAN. How much is the present deficiency according to actuarial estimates in the civil service retirement fund?

Mr. STANS. I am not sure of the latest figure. I am given to understand that it is in the general area of $18 to $20 billion that would be required to put the fund on an actuarial basis.

May I say why the administration believes that is not necessary?

And again I go back to distinguish between the social security fund, which is a trust fund held by the Government for employers and employees other than Government. The civil service retirement fund is contributed in part by employees——

The CHAIRMAN. So is social security.

Mr. STANS. That is correct. But in the case of the civil service retirement fund the Government is the employer, as the Senator has said. In the case of the social security fund, the employers are other than the Government.

Now, the difference is simply this: That to insist on full payment of the $20 billion required to put the fund on an actuarial basis it seems to us is to call into question the credit of the U.S. Government.

The receipts of the fund, including deposits by the Government employees, amount to about $1,700 million in fiscal 1960. Withdrawals from the fund will be less than 60 percent of that. So the balance in the fund actually is continuing to increase.

The CHAIRMAN. Of course in later years the payments out of the funds in the form of benefits will vastly exceed the contributions to the fund by employees.

You will show balanced budgets in these years and the groups which inherit the Government later will show deficits.

Your party will say this is proof of the financial insolvency of the Governments that come later. This is a very cute dodge.

Mr. STANS. It depends mainly on the rates that are in effect and the amount of benefits paid in future years.

The CHAIRMAN. My time is up. I know you have to leave at 12. I think Congressman Curtis should have a chance.

Representative CURTIS. I simply wanted to get some additional information that I think you can supply. The budget provides for an increase in funds for statistical programs. Of course that is something this committee is interested in. I am glad to see the increase.

The question is will this be enough to provide for substantial improvement in construction statistics which have been suggested for several years; and also will there be funds for improving price data.

You may not have the answers to that now. But if you would reply to those questions, and possibly if you want to expand a little bit on how we are increasing funds for gaining additional economic statistics.

Mr. STANS. Yes, I will be glad to submit a statement in detail on that. But I would like to say this: There is a significant increase in the budget for improvement of statistics. One of those is in the case of construction statistics in which a new relationship has been worked out between the Department of Labor and the Department of Commerce to make the development of those statistics more efficient and more effective.

There is also money in the budget for improving the Consumer Price Index and for a number of other improvements in statistical areas that I think will be helpful to this committee and to others in the Government who rely upon that type of information.

(The additional information requested follows:)

Basic improvement is provided in the budget for 1960 for a number of statistical series, including construction statistics, price indexes, and the national income and product accounts. These proposals are summarized, with other recommendations for major statistical programs, in special analysis I of the 1960 budget document. A copy of this special analysis appears below, and descriptions of the changes recommended for construction and price statistics and the national income and product accounts are given in the following paragraphs:

*Construction statistics.*—The need for improvement of construction statistics has been emphasized repeatedly in recent years. Recommendations for 1960 include new administrative arrangements in this area, consolidating responsibility for collection of construction statistics in the Bureau of the Census, and also increase the funds available for this program from about $600,000 in 1959 to $1 million in 1960.

The funds included in the Census Bureau budget estimate for 1960 are designed to provide more adequate data on construction activity. They will be used: (1) to improve the identification and listing of new nonresidential projects;

(2) to enlarge the coverage and improve the reliability of estimates of new housing starts; (3) to develop more accurate estimates of the month-to-month rate of expenditures on the total volume and major categories of construction; and (4) to initiate a new quarterly series (on a national basis, without regional or other breakdowns) on expenditures for additions, alterations and repairs. The increase of $120,000 available to the Bureau of the Census in fiscal year 1959 is being used to initiate work on improving the identification and listing of new nonresidential projects, with emphasis on large projects.

*Price statistics.*—The 1959 appropriation to the Bureau of Labor Statistics included an increase of $100,000 for specific improvements in price statistics. This increase is beng used to improve the quality of price data in the Wholesale Price Index and also—on request of the House Appropriations Committee—to improve the medical care component of the Consumer Price Index and for work on the City Worker's Family Budget.

The 1960 budget includes funds for improving price collection for the Consumer Price Index so that sudden price changes may be reflected in the index more accurately and more promptly. The increase of more than $200,000 recommended for the Bureau of Labor Statistics in this area is to initiate work designed (1) to increase the frequency of price collection for some important commodities which have wide fluctuations in price, (2) to expand the number of items for which prices are collected to give better representation to certain types of articles, and (3) to increase the number of price quotations per city for items for which price variability is large. In addition, an amount of $230,000 is recommended for the Bureau of Labor Statistics to begin preparatory work for a major revision of the Consumer Price Index which would not be ready for publication before January 1963. Periodic major revisions are necessary to keep the index up to date in reflecting consumer expenditure patterns which affect the accuracy of the measurement of price changes, and the last major revision was made in 1950–52.

*National income and product accounts.*—Recent reviews and appraisals of our national income accounts, by the National Accounts Review Committee of the National Bureau of Economic Research, the Joint Economic Committee, and other groups, have highlighted the need for specific improvements in these accounts, compiled by the Office of Business Economics in the Department of Commerce. Appropriations for 1959 included an increase for work in this area, making it possible for the Office of Business Economics to complete preparation of quarterly estimates of gross national product in constant dollars and to initiate work, on a limited scale, on the preparation of net output measures and on the estimation of purchases and sales, by industry. The increase of $115,000 also included first-year costs for inititating work on a survey of U.S. private investments in foreign countries (a 2-year program).

The increase of about $150,000 recommended for the Office of Business Economics in 1960 provides for continuation or extension of projects undertaken in 1959 to strengthen the national income and product accounts. The increase is planned to supplement the quarterly estimates of GNP in constant dollars with annual estimates by industry providing an additional tool for analyzing current economic conditions. The increase also provides for additional work on estimating purchases and sales by industry, and for completion of the survey of foreign investments.

*Other recommendations for 1960.*—Other increases recommended for current statistical programs in 1960 include funds for improving the accuracy and usability of foreign trade statistics (Bureau of the Census); conversion of monthly series on employment, hours, and earnings and on industrial hazards to the revised Standard Industrial Classification, for comparability with other series (Bureau of Labor Statistics); preparing estimates of labor requirements for specific types of construction activity (Bureau of Labor Statistics); and provision of additional mechanical tabulation facilities (Office of Education).

Funds for periodic census programs in the 1960 budget include $86.5 million for the 1960 decennial censuses of population, housing, and agriculture; and $6 million for the 1958 economic censuses of business, manufactures, and mineral industries.

## Special Analysis I. Principal Federal Statistical Programs

Reprint of pages 1000 to 1003 from the Budget of the U.S. Government for the fiscal year ending June 30, 1960

BUREAU OF THE BUDGET, JANUARY 1959

(Detail will not necessarily add to totals, because of rounding)

The Budget for 1960 includes requests amounting to $38.2 million for the current programs of the major Federal statistical agencies, an increase of $1.6 million over the amount provided in 1959. In addition, funds totalling $92.8 million are requested for periodic programs, primarily the decennial censuses.

This special analysis describes the changes in the statistical program which are proposed for 1960, including changes in responsibilities and increases in funds, both of which are expected to result in improvements and better balance of the overall Federal statistical program. These improvements will be reflected in the amount and usefulness of the information provided to the Congress, the Council of Economic Advisers, the executive departments and agencies, and other public and private analysts who need data to appraise the functioning of the economy, the welfare of the people, and the status of particular Federal programs.

The need for comprehensive, timely, and accurate information, collected by various agencies in the course of performing their specific functions, but integrated into a coordinated intelligence plan, has long been recognized. The increased funds requested for 1960 will further a program to bring our statistical resources to a level demanded by modern needs, although they will by no means bring it to full-scale accomplishment. The improvements build on the concept, made explicit last year, of using the national income and product accounts as a framework for appraising weaknesses and gaps in economic statistics. In addition, a few of the most essential requirements for maintaining and improving statistics to meet specialized program objectives have been included in the 1960 budget request.

### PROPOSED TRANSFERS OF RESPONSIBILITIES

*Construction statistics.*—Arrangements have been made to improve significantly the Federal Government's collection and dissemination of construction statistics. They will be consolidated in the Department of Commerce and a substantial increase in funds to finance expanded work is recommended.

Previously, statistics on construction of residential units and public construction were compiled by the Bureau of Labor Statistics in the Department of Labor and private nonresidential construction statistics were compiled by the Business and Defense Services Administration in the Department of Commerce. Also, in 1959, appropriations to the Bureau of the Census provided an increase of $120,000 over 1958 to initiate collection of reports on the progress of construction of large projects.

Under the new plan, the Bureau of the Census will collect and release statistics on all phases of construction, including the widely used figures on housing starts and dollar volume of construction activity. In 1960, an increase of $400,000 is requested for the integrated construction statistics program. These new funds, together with the amounts previously available in the Bureau of Labor Statistics, the Business and Defense Services Administration, and the Bureau of the Census, will provide the construction statistics described below under Current programs, with needed improvements.

*Labor force statistics.*—Arrangements have been made to give the Department of Labor the responsibility for planning, guidance, and publication of labor force statistics obtained from the Current Population Survey. At the present time, the Census Bureau publishes labor force and overall employment and unemployment statistics, while the Bureau of Labor Statistics collects data on nonagricultural employment based on establishment payroll reports, and the Bureau of Employment Security compiles statistics on unemployment insurance claims. Under the new plan, the Department of Labor will publish current comprehensive labor force, employment and unemployment information in place of the joint release of this information previously made by the Departments of

Commerce and Labor. The Bureau of the Census will continue to collect and tabulate labor force statistics from its Current Population Survey sample of households as an agent of the Bureau of Labor Statistics. These new arrangements do not involve any overall increase in funds but analysis of labor force, employment and unemployment statistics will be facilitated and usefulness of the statistics will be enhanced by consolidating the responsibility for these programs in a single agency.

CURRENT PROGRAMS

Growth in the principal current statistical programs reflects the continued demand for improvement in our statistical system. Users want more reliable statistics, in greater detail, on a faster time schedule. In 1960, principal emphasis is centered on the improvement of construction statistics, and the necessary work of repairing and maintaining at acceptable levels of accuracy a number of the important current economic indicators. The 1959 appropriations provided for minor expansion in a number of fields with some emphasis on the areas of production and distribution and national income accounts. About half of the dollar increase shown between 1959 and 1958 is accounted for by the additional costs of the pay increase and increased postal rates.

The summary of principal current statistical programs shown below consolidates the programs of the major agencies, classifying them by broad subject matter area to indicate the interrelationships of programs carried out by different agencies and to aid in evaluating the Government's overall statistical system. The increases are limited to the most urgent items.

*Direct obligations for principal current statistical programs, by broad subject areas*

[In millions]

| Program | 1958 actual | 1959 estimate | 1960 estimate |
|---|---|---|---|
| Labor statistics (Departments of Labor, Commerce, and Agriculture) [1] | $6.4 | $6.9 | $7.4 |
| Demographic statistics (Departments of Commerce, Agriculture, and Health, Education, and Welfare) | 5.5 | 5.9 | 6.0 |
| Prices and price indexes (Departments of Labor and Agriculture) | 3.5 | 3.8 | 4.1 |
| Production and distribution statistics (Departments of Agriculture and Commerce) | 12.9 | 14.0 | 14.1 |
| Construction and housing statistics (Departments of Commerce and Labor) [2] | .8 | .8 | 1.2 |
| National income and business financial accounts (Departments of Commerce, Treasury, and Agriculture; Federal Trade Commission, and Securities and Exchange Commission) | 4.6 | 5.1 | 5.3 |
| Total, principal current programs | 33.7 | 36.6 | 38.2 |

[1] Departments of Labor and Agriculture in 1960.
[2] Department of Commerce in 1960.

The agencies whose programs are included in this summary, in whole or in part, are shown in the table at the end of this analysis. Many other agencies contribute to the statistical system by recording and reporting on their administrative operations or summarizing regulatory reports, claims for benefits, or other information supplied by the public. In the interests of economy, the statistical system makes as much use as possible of such administrative recordkeeping, rather than initiating duplicate collections of data. Budget information for such agencies is not uniformly included in this summary, however, because of the difficulty of allocating separate cost figures for statistical information arising as a byproduct from program operations.

Shifts of emphasis among the broad subject areas are summarized in the discussion below, which lists the more important proposals in each area. In comparison with similar summaries in the past, the classification by broad areas has been affected by the proposed transfer of responsibility for labor force data from the Department of Commerce to the Department of Labor. In former years, all statistics derived from the Current Population Survey were classified as labor statistics, since this was their principal nature. Now, those statistics subject to the transfer continue to be included with labor statistics, and the remainder have been shown as demographic statistics. Estimates of the cost of such demographic statistics have been made for 1958 and 1959 so that the figures shown in the summary in this analysis are on a comparable basis for each subject area.

*Labor statistics.*—Two increases over the present program are recommended for 1960, both of which concern projects that are to be undertaken by the Bureau of Labor Statistics. In the first, estimates of labor requirements for specific types of construction activity, based on modern construction methods, will be developed for use in estimating the impact of new construction programs on employment and for improving productivity statistics. An increase of about $160,000 is included for this proposal. The second project requires about $250,000 to provide for converting the monthly employment, hours and earnings, and industrial hazards series to the revised Standard Industrial Classification. As a necessity for maintaining Government statistical series on a comparable basis, the Bureau of the Budget has recommended that all agencies adopt this revised classification and introduce it into their statistical compilations for 1958 or as soon thereafter as possible.

Other programs in this subject area, for which no increases are requested in 1960, are the statistics compiled by the Bureau of Labor Statistics on wages, labor turnover, and foreign labor conditions, as well as the labor force, employment and unemployment statistics for which responsibility will be transferred to the Labor Department in 1960. This area also includes statistical work by the Agricultural Marketing Service on farm labor.

*Demographic statistics.*—An increase of nearly $100,000 over the 1959 estimated obligations is requested for the Office of Education in the Department of Health, Education, and Welfare, in large part to provide additional mechanical tabulation facilities. Not included in this analysis are funds under title X of the National Defense Education Act for grants to the States for improvement of educational statistics which amount to $1 million estimated obligations in 1959 and $1.5 million in the 1960 budget request.

No changes are requested for other current programs of demographic statistics, which include: National statistics of births, deaths, marriages, and divorces compiled by the National Office of Vital Statistics in the Public Health Service; the National Health Survey conducted by the Public Health Service; population characteristics, estimates and projections, migration, and income statistics prepared by the Bureau of the Census; and studies of the farm population by the Agricultural Marketing Service.

*Prices and price indexes.*—An increase of more than $200,000 over 1959 is recommended for the Bureau of Labor Statistics to improve price reporting for the Consumer Price Index by increasing the frequency of price collection for important commodities which show wide price fluctuations; by expanding the pricing sample to include better representation of certain types of articles; and by increasing the number of price quotations per city for items for which price variability is large. These changes will enable the Consumer Price Index to reflect sudden price changes both more accurately and more promptly. An additional request for funds for preparatory work in 1960 for a periodic revision of the Consumer Price Index is described below, under Periodic programs.

No changes are proposed for the wholesale price series compiled by the Bureau of Labor Statistics nor for the programs of the Agricultural Marketing Service on prices received and paid by farmers and on factors affecting prices, supply, and consumption of agricultural products.

*Production and distribution statistics.*—In 1960, about $100,000 is recommended for improving the accuracy and usability of foreign trade statistics compiled by the Bureau of the Census by providing funds to work with the Customs Bureau and importers and exporters to eliminate inaccuracies in the basic documents and to improve the summary tabulations for analysis of foreign trade. Increases in 1959 appropriations provided for some improvements in the field of agricultural production. The 1959 budget involved increases in several Census Bureau programs, as part of the integrated program to improve basic current statistics on the operation of the economy aid to strengthen our national economic accounts, for improving sales and inventory statistics for manufacturing industries and for retail and wholesale trade.

In 1960 other programs in this area are expected to remain at the 1959 level. They are: The current programs of the Bureau of the Census on retail, wholesale, and service trades, manufacturing, and agriculture; the Agricultural Marketing Service programs on crop and livestock estimates; and the Agricultural Research Service program on the economics of farm production.

*Construction and housing statistics.*—In 1959, the Bureau of the Census initiated work, primarily methodological, looking toward the development of improved estimates of construction activity. With additional funds and the centralied responsibility for construction statistics, as explained above, the Census Bureau in 1960 will maintain the present series on housing starts and construction activity, will work toward the improvement in coverage and accuracy of these series and will initiate a new quarterly series on expenditures for maintenance, repairs, and alterations of existing properties.

Under the proposed arrangements, there will be no program for compilation of construction and housing statistics either in the Bureau of Labor Statistics or the Business and Defense Services Administration. However, labor requirements for construction activity, as noted above, will be developed by the Bureau of Labor Statistics as part of its work on productivity estimates.

*National income and business financial accounts.*—An increase over the 1959 program of about $150,000 is requested for further improvement and extension of the national income accounts. In 1959, the Office of Business Economics is preparing quarterly estimates of gross national product in constant dollars, is initiating preparatory work on estimates of purchases and sales by industry, and has begun a survey of United States private investments in foreign countries. The funds requested in 1960 will provide for completing the survey of foreign investments, for developing product estimates in constant dollars by industry, and for expanding work on the estimation of purchases and sales by industry. Real net product estimates by industry, consistent with other national income and product estimates, will provide an additional tool for the analysis of current economic conditions by showing changes in the contribution each major industry makes to the net national product.

The category "National income and business financial accounts" includes all the work of the Office of Business Economics—preparing estimates of national income and product, measuring and analyzing business trends, and computing the balance of international payments. It also includes the work of the Internal Revenue Service in tabulating statistics from personal and corporate income tax returns; estimates of farm income by the Agricultural Marketing Service; statistics on the financial and other operations of State and local governments compiled by the Bureau of the Census; the quarterly financial reports program, presenting income and balance sheet data for manufacturing corporations, conducted jointly by the Federal Trade Commission and the Securities and Exchange Commission; and other economic statistical series compiled by the Securities and Exchange Commission. In 1959, for the first time, important items of information from individual income tax returns were tabulated and made available by the Internal Revenue Service within the year in which the returns were filed. This speeded-up program will be continued. No increases in funds, other than those noted above for the Office of Business Economics, have been requested for 1960 for the programs included in this category.

### PERIODIC PROGRAMS

Periodic programs are summarized separately because the wide fluctuations in their costs from year to year would obscure comparisons of annual costs of the current statistical programs, and would prevent drawing reasonable conclusions on the status of these programs. Included in the periodic programs are the major censuses, scheduled by law at 5- or 10-year intervals, and initiation of a major program to revise the Consumer Price Index.

*Periodic censuses.*—The periodic censuses are important because they provide a wealth of information on a detailed classification basis, with many cross-classifications of characteristics which the current statistics programs cannot provide; because they supply information on small areas not available from any other source; and because they provide a frame or benchmark for many current statistical series.

Funds are requested to continue work on the censuses of business, manufactures, and mineral industries which will be taken early in 1959 covering the year 1958. These censuses, taken every 5 years, provide data on the volume of production and trade, the number, size, geographical distribution, and other characteristics of 3.3 million business and industrial enterprises. The 1959 appropriation provided for the collection of the information, and the 1960 request for $6 million new obligational authority will provide for most of the processing and tabulating work and for printing preliminary bulletins. A final request will be required in 1961 to complete the tabulation of all summary tables and for the final printing costs.

Funds requested for the decennial census program in 1960, $86.5 million, represent a large part of the cost of the agriculture, population, and housing censuses. Appropriations for preparatory work on these censuses in 1958 and 1959 amounted to nearly $11 million, and it is estimated that an additional $20.5 million for tabulating and printing in later years will bring the total cost of these three censuses to $118 million. These costs are based on the expectation that the population to be enumerated—the principal "workload"—will approach 180 million by April 1, 1960. Ten years ago, the population enumerated was just over 150 million. The number of farms, on the other hand, has decreased. Also implicit in these estimates are the savings made possible by specially developed electronic equipment. The funds requested in 1960 will provide for the enumeration and part of the processing and tabulating work for these censuses. A large part of the information on characteristics of population, housing, and farms will be collected from a 25% sample. This sampling, together with the use of electronic equipment, is expected to speed up the publication of detailed results, making them more timely and thereby considerably more useful. Enumeration of farms will begin in the fall of 1959 and of population and housing in April 1960.

The 1957 census of governments will be completed this year, and no funds are requested in 1960.

*Major revision of the Consumer Price Index.*—Every few years a survey of consumer expenditures is a necessary part of keeping the Consumer Price Index up to date. Occasional surveys of consumer buying are necessary to make the index reflect in proper proportion the effect of current price changes in specific grades and types of articles, shifts in types of outlets patronized, and other changes in consumer expenditure patterns which affect changes in the general price level. This basic series was last revised in 1950–52. An amount of $230,000 is recommended for the Bureau of Labor Statistics to engage in preparatory work on a consumer expenditure survey and other research necessary to appraise and revise the index. An effective revision will take a number of years and several million dollars. The revised index is not expected to be ready for publication before January 1963.

*Direct obligations for principal statistical programs, by agency*

[In millions]

| Agency | 1958 actual | 1959 estimate | 1960 estimate |
|---|---|---|---|
| CURRENT PROGRAMS | | | |
| Department of Agriculture: | | | |
| Agricultural Marketing Service: | | | |
| Economic and statistical analysis | $1.6 | $1.6 | $1.6 |
| Crop and livestock estimates | 5.7 | 6.3 | 6.3 |
| Agricultural Research Service: | | | |
| Farm economics research | 2.7 | 3.0 | 3.0 |
| Department of Commerce: | | | |
| Bureau of the Census | 8.2 | 8.7 | 8.7 |
| Business and Defense Services Administration: Construction statistics | .1 | .2 | ---------- |
| Office of Business Economics | 1.1 | 1.3 | 1.4 |
| Department of Health, Education, and Welfare: | | | |
| Office of Education: | | | |
| Research and statistics | .6 | .7 | .8 |
| Public Health Service: | | | |
| National Office of Vital Statistics | 1.6 | 1.6 | 1.6 |
| Public Health methods and reports | 1.9 | 2.1 | 2.1 |
| Department of Labor: | | | |
| Bureau of Labor Statistics | 7.5 | 8.0 | 9.5 |
| Treasury Department: | | | |
| Internal Revenue Service: | | | |
| Statistical reporting | 2.4 | 2.7 | 2.7 |
| Federal Trade Commission: | | | |
| Financial reports | .2 | .2 | .2 |
| Securities and Exchange Commission: | | | |
| Operational and business statistics | .2 | .2 | .2 |
| Total, current programs | 33.7 | 36.6 | 38.2 |
| PERIODIC PROGRAMS | | | |
| Department of Commerce: | | | |
| Bureau of the Census: | | | |
| 1958 censuses of business, manufactures, and mineral industries | 1.2 | 7.3 | 6.0 |
| 18th decennial census | 4.3 | 6.4 | 86.5 |
| 1957 census of governments | .8 | .6 | ---------- |
| 1954 censuses of business, manufactures, and mineral industries | .1 | ---------- | ---------- |
| Department of Labor: | | | |
| Bureau of Labor Statistics: | | | |
| Revision of Consumer Price Index | ---------- | ---------- | .2 |
| Total, periodic programs | 6.4 | 14.3 | 92.8 |
| Total, principal statistical programs | 40.1 | 50.9 | 130.9 |

Representative CURTIS. Thank you.

Now, one other thing.

I wonder if you could supply for the record the cost and revenues in connection with each of the major types of postal service—increase in revenues—for fiscal 1958, 1959, and 1960. That is for the record.

Mr. STANS. For each of the classes of postal service?

Representative CURTIS. Yes.

Mr. STANS. I don't think, sir, that that information is available up to date. The information that fixes the costs and revenues by classes of postal service is contained in the cost ascertainment report of the Post Office Department. And I think the latest one available is for the fiscal year 1957.

Representative CURTIS. Could you supply for the record any additions to that statement as to what data there might be and where you could refer the committee?

Mr. STANS. I will check with the Post Office Department and get whatever information is available and put it in the record.

(The material referred to follows:)

The budget document contains, on page 794, the following table on mail volume and revenues by class of mail or service for the fiscal years 1958, 1959, and 1960. Cost data by class of mail or service are available from the Post Office Department's cost ascertainment reports only for actual years. No estimates are made for fiscal years not yet completed. The cost ascertainment report for the fiscal year 1958 is nearing completion and will be available in the near future from the Department.

*Estimated volume of mail and special services, and postal revenue*

[Estimated as of Nov. 26, 1958]

| Classification | 1958 actual | | | | 1959 estimate | | | | 1960 estimate | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Pieces or transactions | Revenue | Percent of increase over 1957 | | Pieces or transactions | Revenue | Percent of increase over 1958 | | Pieces or transactions | Revenue | Percent of increase over 1959 | |
| | | | Units | Revenue | | | Units | Revenue | | | Units | Revenue |
| Domestic mail: | *Thousands* | *Thousands* | | | *Thousands* | *Thousands* | | | *Thousands* | *Thousands* | | |
| First class | 32,218,319 | $1,084,130 | 2.08 | 2.09 | 33,229,938 | $1,497,767 | 3.14 | 38.15 | 34,865,759 | $1,591,680 | 4.92 | 6.27 |
| Airmail | 1,434,709 | 136,141 | −3.29 | −2.43 | 1,453,186 | 177,930 | 1.29 | 30.70 | 1,476,254 | 182,672 | 1.59 | 2.67 |
| Second class | 7,147,956 | 65,623 | 3.77 | −1.22 | 7,005,993 | 78,217 | −1.99 | 19.19 | 7,039,516 | 82,239 | .48 | 5.14 |
| Controlled circulation publications | 144,535 | 7,359 | 15.17 | 9.27 | 169,738 | 10,161 | 17.44 | 38.08 | 175,000 | 10,500 | 3.10 | 3.34 |
| Third class | 15,849,319 | 285,095 | .94 | 1.86 | 16,555,491 | 360,695 | 4.46 | 26.52 | 17,437,208 | 410,619 | 5.33 | 13.84 |
| Fourth class | 1,170,119 | 579,182 | −1.24 | −.68 | 1,159,971 | 582,857 | −.87 | .63 | 1,159,971 | 582,857 | | |
| Domestic fees | | 12,438 | | 88.00 | | 12,500 | | .50 | | 12,600 | | .80 |
| Penalty and official mail | 1,559,759 | 49,545 | 3.31 | 30.32 | 1,545,928 | 63,409 | −.89 | 27.98 | 1,598,664 | 69,540 | 3.41 | 9.67 |
| Franked mail | 66,611 | 2,259 | 9.48 | 8.55 | 69,634 | 3,591 | 4.54 | 58.96 | 69,634 | 3,595 | | .11 |
| Free for the blind | 4,101 | | 1.74 | | 4,274 | | 4.22 | | 4,300 | | .61 | |
| Total domestic mail and revenue | 59,595,428 | 2,221,772 | 1.84 | 1.71 | 61,194,153 | 2,787,127 | 2.68 | 25.45 | 63,826,306 | 2,946,302 | 4.30 | 5.71 |
| Add proposed rate increase, fourth class mail | | | | | | | | | | [1] 88,768 | | 100.00 |
| Total domestic mail adjusted | 59,595,428 | 2,221,772 | 1.84 | 1.71 | 61,194,153 | 2,787,127 | 2.68 | 25.45 | 63,826,306 | 3,035,070 | 4.30 | 8.90 |
| International mail: | | | | | | | | | | | | |
| Surface mail | 352,618 | 38,276 | −4.60 | −5.53 | 403,184 | 45,897 | 14.34 | 19.91 | 419,311 | 50,405 | 4.00 | 9.82 |
| Airmail | 181,865 | 40,023 | −3.82 | −1.68 | 202,663 | 47,642 | 11.44 | 19.04 | 211,783 | 52,950 | 4.50 | 11.14 |
| Mail transit revenue | | 9,561 | | 5.02 | | 10,612 | | 10.99 | | 11,000 | | 3.66 |
| Total international mail (originating) | 534,483 | 87,860 | −4.33 | −2.73 | 605,847 | 104,151 | 13.35 | 18.54 | 631,094 | 114,355 | 4.17 | 9.80 |
| Total volume and revenue from mail | 60,129,911 | 2,309,632 | 1.78 | 1.54 | 61,800,000 | 2,891,278 | 2.78 | 25.18 | 64,457,400 | 3,149,425 | 4.30 | 8.93 |
| Special services: | | | | | | | | | | | | |
| Mail connected special services | 377,367 | 140,147 | −13.79 | 11.95 | 380,700 | 144,700 | .88 | 3.25 | 384,800 | 146,500 | 1.07 | 1.24 |
| Money order revenue | 312,411 | 71,018 | −7.12 | 11.17 | 314,300 | 71,000 | .60 | −.03 | 312,200 | 70,500 | −.67 | −.71 |
| Postal savings revenue | 6,065 | 10,111 | −26.59 | −19.31 | 5,000 | 9,500 | −17.56 | −6.04 | 3,000 | 9,000 | −40.00 | −5.26 |
| Box rents | | 26,635 | | −.20 | | 27,625 | | 3.72 | | 29,000 | | 4.97 |
| Unassignable revenue | | 6,776 | | 3.50 | | 7,900 | | 16.59 | | 8,505 | | 7.66 |
| Total revenue from mail and services | | 2,564,319 | | 2.21 | | 3,152,003 | | 22.92 | | 3,412,930 | | 8.28 |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Deduct expenditures not subject to appropriation: | | | | | | | | | | | | |
| Judgments | | 200 | | 18.34 | | 200 | | | | 200 | | |
| Stamped-embossed envelope purchases | | 7,658 | | 14.47 | | 8,709 | | 13.72 | | 8,780 | | .81 |
| Indemnities, claims, etc | | 6,228 | | 16.71 | | 6,162 | | −1.06 | | 6,120 | | −.68 |
| Total expenditures not subject to appropriation | | 14,086 | | 15.50 | | 15,071 | | 6.99 | | 15,100 | | .19 |
| Net revenue from mail and services | | 2,550,233 | | 2.15 | | 3,136,932 | | 23.00 | | 3,397,830 | | 8.32 |
| Receipts for public service | | | | | | 171,259 | | 100.00 | | 172,000 | | .43 |
| Total net postal revenue | | 2,550,233 | | 2.15 | | 3,308,191 | | 29.72 | | 3,569,830 | | 7.91 |

[1] Rate increases pending before Interstate Commerce Commission.

Representative CURTIS. One final area: How far are we getting on this total—or do I understand we are working on a total Government inventory of lands, buildings, and so forth, and so on?

Is that true?

Mr. STANS. Well, that, sir, is one of the important items of information in the report that Senator Douglas mentioned earlier at this hearing this morning. It is an inventory of the property owned by the Federal Government to the extent that such an inventory can be prepared from available information.

Representative CURTIS. Now, that is complete now?

Mr. STANS. I don't know—no, I don't think it is complete. I think it is gaining in completeness from year to year. But the report speaks for itself in indicating that there are still a number of areas of information that need to be added.

Representative CURTIS. Now, one specific thing. Does that include —and I want to apologize for not being more familiar with that report—does that include cash and credits like counterpart funds, for example?

Mr. STANS. I don't believe it does.

Representative CURTIS. There was some mention of counterpart funds. How about—I wonder if you will either give me now, or supply for the record, what there might be in Public Law 480 funds?

First let me ask you: You don't call those counterpart funds; do you?

Mr. STANS. We don't call them counterpart funds. But the request from Congressman Patman is for a statement which includes Public Law 480 moneys as well.

Representative CURTIS. It would include those and it would be segregated so we can tell how much is counterpart and how much is Public Law 480; is that right?

Mr. STANS. That is right.

(The information referred to is included in the material previously inserted above on p. 50.)

Representative CURTIS. That is all.

Representative PATMAN. Now when the social security law was being advocated in the early 1930's, it was contemplated by many Members who were supporting that social security law at this time, that this reserve fund would eventually be large enough to absorb— that is, wholly own—the entire national debt. And the argument was made then that the interest paid on the debt held by the social security fund would go back to the people. Therefore, the national debt would not be so burdensome.

Now, we have a situation where there is an $18 billion actuarial deficiency if the figures advanced by Senator Douglas are correct. I know there are powerful influences in this country in favor of higher and higher interest. Of course, that means lower and lower price of existing Government bonds.

Now, if that $18 billion was made available where these funds are supposed to go, it is possible that the competition for the outstanding Government bonds would be sufficiently strong to bring many of those issues back to par now. I hope that the Director of the Bureau of the Budget will not be persuaded to recommend against supplementing these funds to bring up that deficiency, because the fund will be in competition with others in the existing Government bond markets and other markets.

Mr. STANS. I shall be happy to discuss that with Secretary Anderson and be guided by his judgment as well. I think the way the gentleman phrased the question it appeared as though he was speaking of an $18 billion deficiency in the Social Security fund. Including the Civil Service Retirement fund?

Representative PATMAN. That is right. So if we had been every year making these funds available, we would have $18 billion more now invested in Government bonds probably. Government bonds have been selling pretty low; in fact lower than they have in 25 years. And they keep on going down. The market is thin. This $18 billion would have a tremendous effect on the market.

That is all, Mr. Chairman.

The CHAIRMAN. We thank you, Mr. Stans, for coming.

Representative CURTIS. Mr. Chairman, in regard to this report of the Federal real estate and personal property inventory report of the Government Operations Committee, I notice that it is the committee of Congress that is attempting to do this. It states: "Fourth attempt to get this comprehensive inventory."

Has the Bureau of the Budget been assigned to cooperate in this area? Does the Bureau of the Budget have a program of its own underway to try to do this?

Mr. STANS. The Bureau of the Budget does not have an active part in the development of that information. Much of it comes from the General Services Administration which has property responsibility. And, of course, much of it comes from the individual agencies.

Now, I think the gentleman raises a good point as to whether or not the development of some of that information might be the responsibility of the executive branch.

If it were, I think the responsibility would fall within the Bureau of the Budget. Unfortunately even the Bureau of the Budget has budgetary problems, and we have no money to undertake that sort of study at this time.

Representative PATMAN. One other question, Mr. Chairman.

I don't see anything in that book, in that report, that includes the assets in the form of loans that have been made to the different countries of the world. Are they in here? I don't think they are. And I think that would be an interesting part of the study, to not only include the things that they have included, which are interesting, but, also, to carry the debts of foreign nations to the United States as an asset, whether they are or not.

Mr. STANS. I think the gentleman is correct that the report is incomplete. It does include foreign loans, but I recall that it doesn't include all the gold reserve that we have and things of that character, and I don't believe that it purports to be complete yet.

Representative PATMAN. There is no dispute at this point about the fact that the gold belongs to the U.S. Government.

Mr. STANS. There is no dispute that I know of.

The CHAIRMAN. On behalf of the Senate, I want to congratulate the House of the Representatives for the excellent work done by its Committee on Government Operations in making this thorough study which neither the Bureau of the Budget nor any other executive agency of the executive body had initiated or carried through.

So I want to congratulate the members of this committee in the House on the marvelous way in which they are served by their Committee on Government Operations. And I am very glad that the Bureau of the Budget takes into account the excellence of the work of the legislative branch and is beginning to make good on promises to help make good its past deficiencies.

We will adjourn until tomorrow morning at 10 o'clock, when we will meet in this room for a panel on the "Economic Outlook."

At the request of Congressman Bolling the following is made a part of the record:

FEBRUARY 2, 1959.

MR. MAURICE H. STANS,
*Director U.S. Bureau of the Budget, Executive Office Building*

DEAR MR. STANS: At the time of your appearance before the Joint Economic Committee, last Wednesday, January 28, I was, to my regret, unavoidably absent from the city. Since my return I have read the Committee record with interest. I am now writing to you to request you to submit answers, supplementing your testimony, to a few questions that I would have raised had I been present and that do not appear to have been dealt with either in your prepared statement or in the questioning that followed.

I refer in the first instance to questions 2, 3, and 4, set forth in the Committee's public announcement of your appearance, which are as follows:

(2) What assumptions with respect to prices, national income, personal income, corporate profits, and the like, underlie the President's budget?

(3) In preparing the budget how have the objectives of the Employment Act of 1946 been taken into account; how is the budget expected to contribute to their achievement?

(4) What effect are changes in the budget estimated to have on the gross national product and on Federal revenues?

In addition to these general and basic questions, there are two others to which your answers would be very helpful. They are related and are based on the premise that the cold war is to be taken very seriously, as a possible prelude to hostilities of a character and on a scale never before known by man:

(5) (Further developing question 4:) What consideration has been given to the mobilization of resources—both plant and manpower—that are now idle, to make sure the United States achieves an unchallengeable position of national defense and world leadership? (In this connection, you should be informed that the Joint Economic Committee, in December, heard the testimony of qualified economists to the general effect that a growth in expenditures of as much as $50 billion a year by the end of 2 or 3 years, for military progress, foreign economic assistance, and education, could be borne by the budget largely out of the increased revenues that such expenditures would generate through their effect upon our long stagnant gross national product.)

(6) To what extent, and in what way, does the 1960 budget reflect acknowledgment of the Soviet Union's repeatedly announced resolve to overtake and surpass the United States in production and living standards, as well as to maintain the lead it has in some military sectors and to eliminate its lag in others?

I am sure you will agree with me that these are appropriate questions to raise at this troublous stage of our national history. The consideration given to them by the present administration is a matter that deserves the fullest public disclosure and examination.

Sincerely yours,

RICHARD BOLLING.

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
*Washington, D.C., February 16, 1959.*

HON. RICHARD BOLLING,
*House of Representatives,*
*Washington, D.C.*

MY DEAR MR. BOLLING: Your letter of February 2, 1959, asks that I submit answers to five questions as a supplement to my testimony before the Joint Economic Committee on January 28. Your questions and my answers follow:

1. What assumptions with respect to prices, national income, personal income, corporate profits, and the like, underlie the President's budget?

The budget estimates have been prepared on the basis of prices remaining, on the average, at their present level; exceptions to this general rule may occur in certain cases where agencies may have made allowances for changes based on actual experience with specific areas of procurement. It is assumed that economic recovery will continue throughout the period covered by the budget. The gross national product for the calendar year 1959 is assumed to be somewhat more than $470 billion, compared with $440 billion for calendar year 1957, with $437 billion for calendar year 1958, and with $453 billion (seasonally adjusted annual rate) for the fourth quarter of calendar 1958. Other assumptions of particular importance in the revenue estimates are (in billions):

*Calendar 1958 (preliminary)*

| | Year | 4th quarter (seasonally adjusted annual rate) | Calendar 1959 (assumed) |
|---|---|---|---|
| Personal income | $353.4 | $359.1 | $374 |
| Corporate profits before taxes | 36.4 | 44.0 | 47 |

2. In preparing the budget how have the objectives of the Employment Act of 1946 been taken into account; how is the budget expected to contribute to their achievement?

Throughout the entire process of preparing the budget, the Director of the Bureau of the Budget consulted with the Chairman of the Council of Economic Advisers as well as with the Secretary of the Treasury and other officials who were particularly concerned. Prior to making his final budgetary recommendations, the President also consulted with the Chairman of the Council of Economic Advisers. In these consultations the Chairman of the Council and the President were continually mindful of the objectives of the Employment Act of 1946. In his letter transmitting the Economic Report (p. VI), the President points out, "The chief way for Government to discharge its responsibility in helping to achieve economic growth with price stability is through the prudent conduct of its own financial affairs. The budget submitted to the Congress for the fiscal year 1960, which balances expenditures with receipts at a level of $77 billion, seeks to fulfill this responsibility."

The statement made on page 51 of the Economic Report is also relevant: "Acceptance by the Congress of the expenditure level of the 1960 budget would be the most important single step in discharging Government's responsibility to help preserve the stability of prices and costs through prudent management of its own financial affairs. Moreover, adherence to the proposed expenditure program would provide an opportunity, as budgetary results improve with economic recovery, to promote economic growth by making a start on constructive tax reduction and reform.'

3. What effect are changes in the budget estimated to have on the gross national product and on Federal revenues?

The lower expenditure total for fiscal 1960 reflects in large part the absence of certain nonrecurring 1959 expenditures such as the United States subscription to the increased International Monetary Fund quota and the temporary advances for unemployment compensation. In part it reflects the view that, in a period of sustained recovery, control of Federal expenditures and a balance between income and outgo will contribute to a growing gross national product by promoting substantial price stability. Within the reduced 1960 total, however, increased expenditures are contemplated for a number of programs which promote economic growth. With sustained economic growth, a significant increase in revenues from existing taxes can be anticipated.

Testimony on a specific statistical translation of the budget into gross national product terms was given the Joint Economic Committee by Mr. Paradiso of the Office of Business Economics, Department of Commerce, on January 29. Briefly, he testified that Federal expenditures on an income and product account basis are estimated to rise about $1 billion from fiscal 1959 to fiscal 1960 even though budget expenditures are expected to decline $3.9 billion.

4. What consideration has been given to the mobilization of resources—both plant and manpower—that are now idle, to make sure the United States achieves an unchallengeable position of national defense and world leadership?

The administration does not believe that the United States needs or that our people should be asked to support at this time a total mobilization of plant and manpower for national defense. Nor does the administration believe that national defense programs should be expanded simply to stimulate the national economy. Rather the administration has consistently followed the policy that our national defense programs should be designed to deter war, to provide adequate defense against possible aggression, and to provide retaliatory capability to be used in response to an attack. Furthermore, our defense programs should be capable of being sustained for a possible long period and should not aim at any arbitrary date of assumed maximum danger.

Consistent with this policy, the 1960 budget provides for a military force of about the same overall size and composition in fiscal 1960 as that planned for the end of the current fiscal year. This force, however, will have significantly greater combat power as new weapons continue to be added to inventories. During the last year, we have made substantial progress in key programs for missiles, air defense, and dispersing our strategic bomber force. By concentrating our efforts on the more advanced and promising weapons systems, we can increase substantially our combat capabilities with a relatively small increase in the overall cost of defense. While the estimated total expenditures for the Department of Defense will increase $145 million from 1959 to 1960, those for procurement of missiles and for research, development, test, and evaluation will rise more than $800 million.

The President spent a great deal of time personally in preparing the defense part of the 1960 budget, conferring at length with the Secretary of Defense, the Secretaries of the three services, and the Joint Chiefs of Staff. All are agreed that the 1960 budget provides adequately for our national defense.

To meet further our world responsibilities, the 1960 budget contains recommendations, some of which are for 1959 supplementals, to increase U.S. subscriptions to the International Bank for Reconstruction and Development and the International Monetary Fund, to create a joint development banking institution with our Latin American neighbors, to expand the Development Loan Fund and the technical cooperation and investment guaranty portions of the mutual security program, and to continue in the military assistance program to provide the critical margin of weapons and military equipment required by our allies.

Your question was followed by a parenthetical note concerning testimony of economists that a growth of budget expenditures of as much as $50 billion a year by the end of 2 or 3 years could be supported by the increased revenue that such expenditure would generate. I believe it would be irresponsible on the part of a Government official concerned with budgeting to put any stock in a theory that a dollar spent by the Federal Government will return a dollar in revenues, and that therefore increased expenditures would not affect the net budget results. Although some Federal expenditures may have economic effects greater than the particular amount of outlay involved, it could be true only in very special cases, if at all, that increased spending "could be borne by the budget largely out of the increased revenue that such expenditures would generate." And I certainly cannot believe that military and foreign economic assistance expenditures, which are specifically named in the parenthetical note, increase the productivity of our economy in this respect. Thus, the projection cited of a $50 billion a year increase in the budget must imply a much higher rate of taxation as well. This does not seem to be a wise nor necessary policy goal. Spending, at such a rate would surely bring dangerous inflationary pressures, and taxing at a much higher rate would surely deter long-run economic growth.

5. To what extent, and in what way, does the 1960 budget reflect acknowledgment of the Soviet Union's repeatedly announced resolve to overtake and surpass the United States in production and living standards, as well as to maintain the lead it has in some military sectors and to eliminate its lag in others?

The fact that the Soviet Union sets as its goal the accomplishments of the U.S. national economy is a frank admission that the Soviets have a long way to go to overtake us. These recent announcements by Russia follow a revision of its previous economic plans, a revision made necessary because it fell short. The United States would benefit if Russia concentrated on raising its living standards by the tremendous amounts necessary to approach ours because such progress could be made only by diverting effort and resources from armaments.

Unlike the Soviet Union, the United States does not expect the central government to provide for all the investment and research needed for economic growth. We rely primarily on private enterprise, with the Government fostering conditions for private economic growth and stability. In the coming period, the administration believes that a balanced budget such as that recommended by the President will contribute greatly toward this objective. In addition, some specific budgetary proposals which will promote economic growth can be readily pointed out and were discussed in the budget message. For example, the 1960 budget (1) promotes scientific research and development with record expenditures of nearly $5.5 billion, an increase of more than $0.6 billion over 1959; (2) carries forward civil public works prorgams—now larger than ever before—with $5.2 billion of expenditures, which is $0.7 billion more than in 1959; and (3) encourages the economic development of communities through $2.1 billion of estimated expenditures for helping in 14 major types of capital improvements, an increase of $0.4 billion over 1959—and by the close of fiscal 1960 there will be commitments outstanding of over $6 billion for future Federal expenditures for the same types of improvements. Although there are some duplications in the amounts just cited (community improvements which are also public works), their magnitude certainly indicates that the 1960 budget does not provide for activities which will promote economic progress and growth.

I trust the above answers will be helpful to you. You are correct that such issues deserve the fullest public disclosure and examination and I would be happy to have this letter made part of the record of the recent hearings.

Sincerely yours,

MAURICE H. STANS, *Director.*

(Whereupon, at 12:08 p.m., the committee recessed, to reconvene at 10 a.m., Thursday, January 29, 1959.)

# JANUARY 1959 ECONOMIC REPORT OF THE PRESIDENT

## THURSDAY, JANUARY 29, 1959

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met at 10 a.m., pursuant to recess, in room 362, Old House Office Building, Hon. Wright Patman (vice chairman) presiding.

Present: Senator Douglas; Representatives Patman, Reuss, Kilburn, Curtis, and Widnall.

Also present: Roderick H. Riley, executive director; John W. Lehman, clerk.

Representative PATMAN. The committee will please come to order.

Senator Douglas is delayed a few minutes, and he asked that I go ahead, because one or more members of the panel will have to get away earlier than noon.

This morning we have a panel to discuss the economic outlook. First, what is the outlook for labor force, hours of work, and productivity in comparison with long-run trends.

Second, what are the likely trends in receipts and expenditures of Federal, State and local governments.

Third, what is the outlook for business fixed investment for international investment, residential construction, and inventories.

Fourth, what is the outlook for consumer buying of durables, nondurables and services.

Fifth, what is the outlook for prices.

We have on the panel this morning some very distinguished people.

First, as I call your name, if you will raise your hand.

Ewan Clague, Commissioner, Bureau of Labor Statistics, Department of Labor.

Louis J. Paradiso, Assistant Director and chief statistician, Office of Business Economics, Department of Commerce.

Robinson Newcomb, consulting economist.

Martin R. Gainsbrugh, chief economist, National Industrial Conference Board.

Irwin Friend, professor of economics and finance, University of Pennsylvania.

William F. Butler, vice president, Chase Manhattan Bank.

Oris V. Wells, Administrator, Agricultural Marketing Service, Department of Agriculture.

Louis H. Bean, consulting economist.

We are delighted to have you gentlemen. It is very nice of you to be here and give us the benefit of your views.

Shall we take them up in the order in which the names were called?

Mr. Clague.

Mr. CLAGUE. Mr. Chairman, I have a longer statement here which I shall submit for the record. I have a brief summary which I would like to read.

## STATEMENT OF EWAN CLAGUE, COMMISSIONER OF LABOR STATISTICS, U.S. DEPARTMENT OF LABOR

Mr. CLAGUE. Mr. Chairman and members of the committee, I have been asked to discuss a variety of subjects which come within the purview of the Department of Labor's Bureau of Labor Statistics.

Because of today's time limitations, I shall point out only some of the highlights of the material which we have prepared. I am submitting a more detailed analysis for the record. The charts at the end of this statement illustrate many of the points I am going to make this morning.

### LABOR FORCE

Labor force growth in each of the past 2 years has been considerably less than we technically consider to be normal, so that the total has slipped fractionally below the trend line (chart 1). This generally happens when the demand for labor is relatively light. Projections of long-term trends into the next 2 years indicate an increase of about a million workers a year; however, the actual totals will be largely determined by how steadily the overall economy expands.

In addition to absorbing these new entrants, we still face a considerable reemployment problem. The pattern of employment recovery has been spotty, as the three sections of chart 3 show. Employment in nonfarm industries in December was still more than 1½ million under prerecession levels. The fact that output has recovered more rapidly than employment is not unusual, however.

The factory workweek, which tends to precede changes in employment by several months, is nearly back to prerecessions levels (chart 5).

Another important factor is the stability of nonproduction worker employment during recessions (chart 6). This group—the people who do the administrative, sales, technical, and professional work—is growing steadily, in contrast to the frequent instability and general lack of growth in production worker employment.

Our unemployment analyses, which are summarized in our detailed statement, show that unemployment at yearend was still relatively high among adult male blue-collar workers from the hard-goods manufacturing industries. Rehiring of men in these industries will depend upon an expansion of consumer buying and a resurgence of business investment.

Even with steady gains in total employment, which we have every reason to expect, we may still be faced with continuing pockets of unemployment in some of the industries and areas which were particularly hard hit during 1958.

### PRODUCTIVITY

Estimates of productivity for the year 1958 as a whole, which are still extremely preliminary, indicate little or no increase in total private output per man-hour in relation to 1957. Agricultural productivity continued to grow substantially, but output per man-hour for the private nonfarm sector did not increase, and may have actually declined somewhat from the record high of 1957. This trend was to have been expected, since a drop in output during recessions generally has an adverse effect on productivity.

Changes in productivity were not uniform during the year. The very limited information which we have leads us to think that during the early part of the year, when production was declining, output per man-hour also fell.

However, during the recovery, output per man-hour increased substantially, and in the latter part of 1958 might have surpassed the peak level reached prior to the recession.

As regards the prospects for 1959, our experience during the postwar period has been that the first full year of recovery after a recession has usually shown a higher-than-average increase in output per man-hour. In both 1950 and 1955, for example, the increase for manufacturing was close to 7 percent; for the private nonfarm sector, the increases ranged from 4.5 to 6 percent. Based on past experience, therefore, I would expect 1959 to be a good year from the viewpoint of productivity increases. Whether it will match the gains of previous recovery years, however, will depend on the extent to which output continues to show strong and sustained growth.

### WAGE DEVELOPMENTS

Wage developments during 1958, at least in major collective bargaining situations, were more influenced by the rise in consumer prices and by commitments made in prior years than by the recession. Altogether, increases in wage rates were negotiated or put into effect during the year for about 6.8 million workers covered by major collective bargaining agreements studied by the Bureau of Labor Statistics—including all industries except construction, services, finance, and Government. Almost half of these workers received increases specified in contracts negotiated in earlier years.

The most common increase during 1958—taking into account negotiated, deferred, and cost-of-living adjustments—averaged 12 cents an hour, or about the same as in 1957—chart 12.

There may have been some reduction between 1957 and 1958 in the size of the total wage and fringe benefit package negotiated, but there are no data that can be used to verify this impression.

Hourly and weekly earnings in manufacturing were held down during the early months of 1958 by the decline in hours of work and by a relatively greater drop in employment in the high wage durable goods industries—chart 13.

However, earnings of factory workers have recently risen rapidly and by December were at an alltime high. Their real weekly earnings also advanced, and were virtually back to the previous peak.

In 1959 some 3 million workers covered by major collective bargaining agreements will receive wage rate increases that were specified in agreements concluded earlier. The year 1959 will be a heavy bargaining year since, in addition to agreements that provide for annual wage bargaining, many of the key long-term agreements are subject to negotiations or to reopening. While it is impossible to predict the outcome of these negotiations, wage rates clearly will continue to rise, assuming no interruption to economic recovery.

However, the recent leveling off of the Consumer Price Index will probably reduce escalator increases going to the more than 4 million workers who are covered by current arrangements.

So more stable prices may hold down the total wage rate changes in 1959 as compared with 1958.

### PRICE DEVELOPMENTS

Our major price measures—the Wholesale Price Index and the Consumer Price Index—rose moderately during most of the recession, but have held steady since the economic upturn began in late spring. Between June and December 1958, neither of the two series fluctuated by more than two-tenths of an index point. The recent stability has resulted from a wide variety of changes within the overall index—charts 14 and 16. Some of these have been notable, but none have been especially surprising.

Dominating the trend, and moving virtually independently of the business cycle, have been the prices of farm and food products. As a result of changing supply conditions, these prices rose most sharply at the very time the recession was most pronounced, and then declined at midyear after business activity had begun to improve. Another significant factor during 1958, although not a new one, was the continuing uptrend in the cost of consumer services, which constitute more than a third of the Consumer Price Index.

There were especially sharp rises during this past year in such items as hospital insurance premiums, hospital room rates, local transit fares, and automobile insurance premiums—chart 17.

Prices of manufactured goods, on the other hand, have remained generally unchanged during the past year, although some of them have been edging upward in the latter half of 1958 as business has been improving.

In assessing the significance of the 1958 trends, it is necessary to bear in mind that prices are slower than other economic indicators to reflect the turns of the business cycle. Moreover, there is some evidence that many prices are becoming even less flexible on the down side than in earlier periods of recession. One factor in this connection may be that consumer incomes were better maintained in 1958 than in earlier recessions.

The decline in agricultural and food prices should continue, at a moderate pace, in the coming months, assuming that weather conditions are reasonably favorable. On the other hand, there is every likelihood that the rise in the cost of services will continue.

In addition, the maintenance of the present pace of business recovery will probably exert new upward pressures on industrial prices. Thus, it seems fairly clear that these two opposing forces—declining farm and food prices and rising costs of services and some industrial items—will tend to offset each other in the immediate future, keeping the indexes relatively stable.

For the rest of 1959, however, the problem is not so much what recent trends have been; rather it is how closely prices—including all the costs of doing business—will follow the economic upturn which is now underway.

The major determinants in the short run will be such factors as the strength of consumer and business demand, the rapidity of the recovery, the results of labor-management negotiations, and the availability of money and credit.

CONSTRUCTION

Spending for new construction will provide a substantial lift to the economy in 1959—chart 21. The volume of work put in place will rise above the earlier peak reached in 1955, and dollar volume may reach a new high of about $52 billion. Private construction, which failed to rise in 1958 for the first time since 1949, is expected to resume its growth in 1959, chiefly because of a large increase in expenditures for housing.

It is expected that funds for construction will be generally adequate in 1959, although money for home mortgages probably will become less readily available at the comparatively low downpayments and interest rates prevailing in 1958. In the present legislative framework, it is anticipated that private housing starts will continue at a relatively high rate in the early months of 1959 and will taper off thereafter.

Thus the present outlook is for only a small rise in housing starts above the 1,200,000 units—public and private—which were placed under construction in 1958.

Further declines are anticipated in industrial building because of the sharp reduction in the number of new projects started in 1958. The rate of decline will be much slower than in 1958, however. On the other hand, gains are in prospect for shopping facilities, churches, and schools.

Expenditures for all types of public construction are expected to rise in 1959, with the major impetus supplied by the Federal Government.

Antirecession measures and reevaluation of defense programs have resulted in acceleration of projects, rising contract awards, and large appropriations during 1958; these will cause sizable increases in the amounts spent on direct Federal and Federal-aid construction in 1959. About a third of the increase in public expenditures will be for highways, which form the largest single type of public construction—chart 19.

Representative PATMAN. Thank you very much, Mr. Clague.

(Mr. Clague's material follows:)

MATERIAL SUBMITTED BY EWAN CLAGUE, COMMISSIONER OF LABOR STATISTICS, U.S. DEPARTMENT OF LABOR, TO THE JOINT ECONOMIC COMMITTEE ON JANUARY 1959 ECONOMIC REPORT OF THE PRESIDENT

I. EMPLOYMENT AND UNEMPLOYMENT TRENDS

*Labor force trends*

The total labor force, which includes the employed, the unemployed and the Armed Forces, increased by only a half million between 1957 and 1958, to 71.3 million. For 2 years now, labor force growth has been less than the average annual gain which took place during the first half of this decade. The total increase for the 2 years together has been 900,000 workers—about the growth that would accrue in 1 year if longrun labor force increases took place in a regular, evenly spaced fashion. However, as chart 1 shows, labor force does not usually increase at a smooth yearly pace.

The number of persons in the labor force is, of course, closely related to the size of the population of working age. The size and composition of the labor force also reflect such longrun factors as the tendency for greater proportions of married women to work, the longer periods of schooling for young persons and the trend toward earlier retirement. However, the size of the labor force also expands quickly when the need for manpower is great, such as during periods of national emergency. Conversely, the rate of expansion slows when the demand for labor falls off. These shortrun changes occur mainly among the oldest and the youngest workers and among women. Labor force participation of men in the central ages is not affected by shortrun factors.

This flexibility of labor force movement on the part of women and youths is evident during the course of each year as the labor force expands to supply additional workers for seasonal farm activities, food processing, etc., and contracts when farm and nonfarm work decline in the winter. The range between the summer peak work force and winter low is several million, and it is provided primarily by adult women and young persons whose principal activity during the rest of the year is taking care of their home or attending school.

The same groups also respond quickly to changing conditions of the labor market not associated with regular seasonal fluctuations. They accounted for most of the rapid labor force expansion in 1951, when it was necessary to increase production and enlarge the Armed Forces following the start of the Korean conflict, and also during the rapid expansion of 1955 and 1956. During periods when job prospects were not so favorable, such as in 1954 and 1958, a smaller number of women and youngsters were added to the labor force.

In order to give you an idea of how much the labor force growth can vary from year to year, I shall briefly review the labor force changes since 1951. The rapid expansion of that year added 1¼ million to the labor force in a single year. Growth fell off sharply in the next 2 years, bringing only a million net addition to the size of the labor force. As a result, the average total labor force, which had exceeded the trend value by 450,000 in 1951, was less than 300,000 above in 1952 and by 1953 was back on the trend line, as indicated by chart 1.

Because of the business slowdown and the decline in employment opportunities, labor force growth was also below average between 1953 and 1954, showing an expansion of less than half a million. The recovery and rapid expansion of the economy during 1955 and 1956, however, brought into the labor market a net addition of 1.1 million and 1.5 million workers, respectively. Adult women accounted for more than half of the expansion in the work force in the 2 years. As the chart shows, the total labor force was back on the trend line in 1955, and in 1956 was above the trend by about 700,000.

During 1957, the labor force edged up by only 350,000 as labor demand abated. Additions of adult women to the work force were much smaller than in 1955 and 1956, and labor force participation rates for young workers and men 65 and over declined more than expected on the basis of long-term trends. The total labor force returned to the trend line again.

In 1958, however, with the employment situation worsening in the early months, then improving only moderately, the total labor force fell somewhat below the long-term trend line. The female work force was back to about the size indicated by continuation of trends in labor force participation rates and by the increase in the female population of working age; but there were fewer men under 25 and over 65 than were expected from long-term trends (table 1). The lack of job opportunities undoubtedly deterred some school-age youth from seeking employment. Older men apparently retired from the work force in greater numbers than usual; this too was probably a result of the economic situation, although they had not been particularly hard hit.

Note that the labor force growth which occurred during 1958 actually took place almost entirely during the first quarter of 1958 after allowance is made for seasonal differences (chart 2). This was the period of the sharp drop in employment and rise in unemployment. Between fourth quarter 1957 and first quarter 1958, employment was reduced by nearly 800,000, almost entirely among men in nonfarm jobs. At the same time unemployment rose by 1.3 million—much more than the drop in employment. About 400,000 of the additions to unemployment were accounted for by adult women and young workers coming from outside into the labor force. There was some speculation at that time that this greater than usual entry of women and youths was brought about by efforts of wives and other family members of laid-off workers to replace loss of income.

That undoubtedly was a factor, since there is evidence that the labor force participation rates are higher for wives whose husbands are unemployed than for those with employed husbands. However, a small additional rise in the second quarter was erased in the following quarter and, by the fourth quarter of 1958, the civilian labor force was about the same size as in the first quarter.

*Employment and hours*

Last year when I appeared before you, we were in the midst of an economic contraction. I pointed out at that time that a slow decline in manufacturing employment and hours was already under way in early 1957, but it was not until after August that the declines in the economy became general and sharp. The drop continued until the spring of 1958, and was in many respects the sharpest we had experienced in the postwar period. But if it was relatively sharp, it also proved to be relatively short. During each of the previous two recessions the employment downturn lasted approximately 1 year. Recovery in this recession began after about 8 months. Between April, the recession low point, and last September we recovered approximately 30 percent of the recession employment loss. In the past 3 months, however, there has been little employment gain.

Employment on nonagricultural payrolls dropped by 2,400,000, or 4½ percent, from the prerecession peak in August 1957 until the low point in April 1958. (Normal seasonal variations in employment are discounted in this analysis.) The largest employment loss was in manufacturing, particularly in hard goods industries. (See chart 3.) Industries associated with manufacturing, such as transportation and mining, also showed severe employment losses. Construction employment, after slipping somewhat late in 1957, held relatively stable during most of 1958. Employment in services and finance, on the other hand, generally resisted the decline. Government employment showed consistent growth, most of it related to expansion in State and local school systems.

The factory workweek also dropped sharply during the recession, falling by 1½ hours to a low of 38.5 hours in the spring of 1958. The effect of the combined reduction in employment and hours was reflected in a significant shrinkage of dollar payrolls. Payrolls in manufacturing, mining and construction declined by about 13 percent between August 1957 and April 1958. Both the amount and rate of contraction were sharper than in the downturns of 1948–49 and 1953–54, when the drop over a longer period amounted to about 10 percent.

One of the most significant factors in restricting the depth and duration of this recession was the continued high level of personal consumption expenditures. This was directly related to the relatively small decline in personal income as compared to output and employment. (See chart 4.) The so-called built-in stabilizers played their most prominent role thus far in offsetting recession-caused declines in income. The most important aid in supporting income was unemployment insurance, including the extended benefits under temporary programs which went into effect in the middle of 1958. Recent liberalization of our old-age and survivors' insurance programs also made retirement benefits available to many of the older persons affected by the business decline and, for the first time, to a large number of self-employed farmers.

In addition to Government programs, there were also stabilizing influences developed in the private economy, the most noteworthy of which were increased payments under supplementary unemployment compensation plans as well as expanded programs for severance pay and retirement. Also serving to dampen the decline in personal incomes was the general maintenance or increase of wage rates, and the relative stability of nonproduction worker employment.

The pickup in employment and hours of work following April 1958 continued steadily for about 5 months. Total nonfarm payroll employment, seasonally adjusted, went up about 700,000, or 30 percent of the job decline of the previous fall and winter. Manufacturing, where most of the total decline occurred, recovered about 300,000 of its 1.6 million recession job loss by September—about 20 percent. Much more striking gains were registered in hours of work. The manufacturing workweek had risen most of the way back to the prerecession level by September, and overtime work was again common in many manufacturing industries (chart 5).

The pattern of employment recovery has been spotty, however. In some industries which have been severely affected by the recession, such as transportation and mining, there has been no employment recovery at all during 1958, although the downturn appears to have been arrested. In manufacturing, the recovery of the late spring and summer slowed down during the last quarter of the year, and only the primary metals and transportation equipment industries have continued to report significant gains in either employment or hours. The trend in manufacturing industries, however, has been obscured somewhat by unusually severe winter weather and by industrial disputes in some industries in the past several months. In contract construction there has been little movement other than seasonal since May. Even in trade, where the recession losses were comparatively small, the recovery has been only partial; and during the last few months job changes have been almost entirely seasonal.

*Employment and output*

The fact that output has recovered more rapidly than employment has not been an unusual phenomenon during the recovery phase of recent recessions. The opposite trend often appears in the early stage of a recession, when production declines more rapidly than employment. There are several reasons for this pattern.

One important factor (already alluded to in discussing income trends) is that employment of nonproduction workers—the group engaged in administrative, sales, technical, and professional work—has tended to remain stable in the face of declining output. This has been true of the earlier postwar recessions as well. (See chart 6.) The number of these workers has grown sharply over the past several decades, and now comprises approximately 25 percent of total employment in manufacturing industries. Nonproduction workers reached a peak of 3.9 million in the summer of 1957, and were affected by the recession only to the extent that their number leveled off at about 3.8 million.

There are a number of reasons for the cyclical stability of nonproduction worker employment. Such workers need to be retained for the administrative, clerical and other overhead work which must be continued even in the face of declining production. Also, a prudent regard for the future requires the continuation of many research and development programs. In addition, firms find it advantageous to hold on to scarce and highly trained workers in whom they have made a large investment. These factors, plus the increasing necessity for long-range planning, have led businessmen to discount somewhat the effects of short-term fluctuations in output in appraising their staff needs.

The corollary to the stability of nonproduction worker employment during an economic contraction is that there is no necessity for expansion of this group during the early period of recovery. Thus, between the April 1958 recession trough and this December, nonproduction worker employment in manufacturing has remained unchanged, while production worker employment has gone up by 420,000.

The long-term growth of nonproduction workers is in marked contrast to the frequent instability and general lack of growth in production worker employment. Even during the industrial expansion of 1955 and 1956, employment of production workers was lower than in 1953; in 1953 it was lower than in World War II. In addition, production worker employment has dropped sharply during cyclical downturns.

Another factor making for employment stability during business downturns has been the growing importance of the relatively recession-immune service-type industries as compared to the more volatile goods-producing industries. The former type of employment has been increasing steadily over many years, while there has been little growth in the goods-producing industries—manufacturing, mining, construction, and agriculture. As a result, more than half of our work force is now employed in service-type industries and the proportion has been growing larger every year. (See chart 7.)

*Changes in the workweek*

Another reason for the lag in recovery between employment and output has been the widespread use of changes in the workweek as a means for adjusting labor requirements to output. In periods of rising output the tendency has been to lengthen the workweek first rather than recruit new help, particularly when staffs are on a part-week schedule. When the outlook for a sustained recovery is still uncertain, businessmen have also tended to resort to increased overtime work to meet what may be a temporary rise in demand rather than to assume the expense and obligation of hiring new workers who may shortly have to be laid off. In general, during recent recessions, hours of work have tended to lead changes in manufacturing employment by several months. (See chart 5.) As recovery proceeds, however, it often becomes less expensive to increase the work staff rather than to pay premium wage rates for overtime, and adjustments in employment are then made. But if the outlook for further expansion remains in doubt, businessmen may continue to depend on overtime work rather than shifting their emphasis to recruiting new workers.

There are additional factors which may act to retard employment expansion early in the recovery period. During a recession, producers are forced to take a cautious view of the immediate future—the optimism of the prerecession period is replaced by a more conservative outlook. In an attempt to maintain profit levels in the face of declining sales, efforts are made to cut costs and use production facilities more intensively. Moreover, in periods such as the present, when producers are operating at less than capacity, readjustments of production are made to utilize only the most efficient facilities. All of these factors tend to result in a relatively smaller increase in employment than in output during the early recovery stage of a recession.

*Unemployment*

For about 2 years before the onset of the 1957–58 recession, unemployment showed very little change other than seasonal. The number of jobless averaged 2¾ million, or about 4.2 percent of the civilian labor force. Joblessness began to increase in September 1957, rising sharply during the winter and early spring. At the low point of the recession in April, 1958, more than 5 million persons were looking for work and the seasonally adjusted unemployment rate reached 7.5 percent. For several months thereafter, the unemployment situation was little changed, even though some gains began to show up in employment. Real improvement started in September, and by December the number of jobless had been reduced to about 4 million, with the adjusted rate of unemployment down to approximately 6 percent. (See chart 8.)

The declines in employment were mainly in the durable goods manufacturing, mining and railroad industries, and their unemployment rates rose sharply. (See charts 9 and 10.) In April 1958, the rate in durable goods manufacturing was triple that of a year earlier, and one out of eight workers was out of a job; in the same period, the rates in mining and transportation went up roughly 2½ times. By December, however, the proportion of durable goods workers who were jobless had dropped more than seasonally, to 1 out of 13. Unemployment in service industries and Government, on the other hand, was considerably lower than in other industries throughout most of the recession.

Virtually all major occupational groups showed significant increases in unemployment, but a heavy proportion of the unemployed were adult men who had been working in blue-collar occupations. Craftsmen and operatives, many of whom work in the hard-hit durable manufacturing and related industries, experienced the sharpest rise. At the April low point in economic activity, about 8 percent of the craftsmen and 13 percent of the operatives were jobless. About 16 percent of nonfarm laborers were out of work, but these workers usually have relatively high rates of unemployment. Workers from these three major occupations accounted for nearly two-thirds of all the unemployed, although comprising less than two-fifths of the total employed.

This situation improved somewhat during the latter part of 1958, but at year's end unemployment was still relatively high among male blue-collar workers from the hard goods manufacturing industries. The unemployment rate for operatives had dropped to 9 percent, the rate for craftsmen (7 percent) was only slightly lower than in April, and that for laborers was unchanged because of the unusually severe weather in December.

When unemployment was at a peak in the second quarter of 1958, the greatest increases over the year were to be found among men in the central working ages. This, of course, was directly associated with the concentration of layoffs in hard goods and related industries. Increases among men 55 years and over were smaller, probably reflecting greater seniority rights. Joblessness among women and teen-agers also rose, but this was more the net result of additional persons entering the labor market to seek work than of job losses. By December, unemployment rates were markedly lower than in the spring for all ages except workers 65 years and over. This underscores a situation evident in other business downturns—older workers are not usually as hard hit by layoffs, but once unemployed have a more difficult time finding jobs.

One of the major problems of the recession has been the unusually large number of persons with long spells of unemployment. In mid-1957, about one-half million jobless had been looking for work 15 weeks or longer. This number edged up in the fall of that year and rose sharply in the winter and early spring to a postwar high of 1.9 million in April 1958. This was roughly two-thirds higher than the peak numbers in the recessions of 1949 and 1954. After April, long-term unemployment declined, but not as much as seasonally expected. On a seasonally adjusted basis, the first real improvement came in September (chart 11). By year's end there were still 1.3 million long-term unemployed, of whom 800,000 had been out of work for at least 6 months. As was to be expected, a disproportionate number of these were workers in durable goods manufacturing, mining, and transportation industries, workers in the blue-collar occupations, and older men.

Many of these workers have not been able to transfer to industries which were less affected by the recession. In the first place, they probably could not readily use their skills in other industries. Secondly, because they were mainly family men, they could not afford to take the lower-paying jobs in trade and service. Furthermore, in the industrial areas which were hard hit, trade and service activities were also affected so that job opportunities generally were greatly reduced.

Despite the protracted unemployment of some workers, however, it is important to remember that many other workers were jobless for only short periods of time. Every month, large numbers of unemployed find jobs or voluntarily leave the labor force. In the other direction, there are always substantial numbers of workers losing or quitting jobs or entering the labor force to seek employment. This continuous turnover among the unemployed occurs during recessions as well as in good times. For example, between March and April 1958, when unemployment changed only slightly from 5.2 million to 5.1 million, 2 million unemployed found jobs or left the labor force while 1.9 million left jobs or came from outside the labor force—mainly housewives and students—to look for work.

Nonwhite workers, who are largely in unskilled and semiskilled occupations with high unemployment rates, accounted for one out of five of all the unemployed throughout the downturn and recovery period—the same proportion they comprised prior to the downturn. At the low point in the recession, one out of seven nonwhite workers was jobless. By December 1958, the ratio had decreased to one in eight.

*The year ahead*

Thus, we enter 1959 with a somewhat smaller labor force than had been projected on the basis of 1947–56 growth trends. Projections of these trends into the next 2 years call for an average annual increase of about a million workers, although the actual totals will be largely determined by how steadily the overall economy expands. In addition to absorbing these new entrants, we still face a considerable reemployment problem, despite the achievement of a significant recovery in output and aggregate income. Employment in nonfarm industries in December was still 1.6 million below the prerecession level and unemployment was at a seasonally adjusted level of 4.2 million, or 6.1 percent of the labor force. Well over 2 million jobs would therefore be needed to bring unemployment down to a total of 3 million at the end of 1959, even assuming no change in productivity.

We have every reason to expect a continuation of recovery in aggregate output and employment throughout 1959. Employment gains in service, finance, and State and local governments are likely to continue, but substantial rehiring of men in durable goods industries—still 1 million below the prerecession employment level—will depend upon an expansion of consumer buying as well as a resurgence of business investment in new plant and equipment. Even with steady gains in total employment, we may still be faced with continuing pockets of unemployment in some of the industries and areas which were particularly hard hit during 1958.

## II. PRODUCTIVITY TRENDS

In my testimony last year before the Joint Economic Committee in its hearings on the 1958 Economic Report of the President, I discussed the development by the Bureau of Labor Statistics of measures of productivity based on the gross national product or value added concept. At that time, I indicated that two sets of measures had been prepared, using alternative sources of man-hour data.[1]

[1] One set was based primarily on Bureau of Labor Statistics data which related in concept to hours paid, including paid holidays, vacations, and sick leave. The other set was based primarily on census labor force data and covered, in concept, hours worked, excluding paid holidays, vacations, etc. Differences between the two series could be expected as a result of the change in hours paid for but not worked; but, unfortunately, problems of statistical incomparability could obscure the differences in concept.

The set of output per man-hour measures based on census labor force data cover the total private economy and agricultural and nonagricultural components. The set based primarily on BLS man-hour data covers the same categories, and in addition provides estimates for total manufacturing and nonmanufacturing industries. Both sets cover the man-hours of all persons, including all wage and salary employees, the self-employed and unpaid family workers.

The measures which I discussed last year have since then been revised to accord with revisions in both the constant-dollar gross national product and the man-hour data. The revised estimates covering the years 1947–58 are shown in table 2.[2]

The preliminary estimates for the year 1958 as a whole indicate little or no increase in total private output per man-hour in relation to 1957. Agriculture continued to show substantial growth, but the output per man-hour for the private nonfarm sector did not increase in 1958 over 1957 and may even have declined somewhat.

I should like to make two observations concerning the rather small increase in productivity in 1958. First, it is to be expected that the drop in production during the recession would have an adverse effect on productivity. The drop in output in 1958 seems to have been greater than in the previous two postwar recessions, and this may account for the fact that productivity was more seriously affected in the recession of 1958 than in either the 1949 or 1954 recessions. I should emphasize that the estimates for 1958 are based on preliminary data and subject to revision as more complete data become available.

Second, the estimates which I have been discussing refer to the average for the year 1958 and should not be interpreted to mean that these changes were uniformly distributed during the year. In this connection, it should be noted that much of the discussion in the newspapers and the business journals regarding the sharp increases in productivity in 1958 has related to the increases during the recovery, whereas these estimates of ours reflect the average for the year as a whole, including both the declines and the increases during the year. Based on crude and limited information, we think that during the early part of the year, when output was declining, output per man-hour also fell; but during the recovery phase output per man-hour increased substantially, so that by the latter part of the year it may have surpassed the peak level reached prior to the recession.

Turning now to the prospects for gains in productivity in 1959, our experience during the postwar period has been that the first full year of recovery after a recession has usually shown a higher than average increase in output per man-hour. In 1950, for example, output per man-hour for the total private economy increased about 7 to 8 percent; the increase for the private nonfarm sector was 5 to 6 percent. In 1955, the increase for the private economy was about 4.5 percent; for the nonfarm sector it was also about 4.5 percent. In both years, the increase for manufacturing was close to 7 percent. Based on past experience, I would expect 1959 to be a good year from the viewpoint of productivity increase. Whether it will reach the gains of previous recovery years will depend, however, on the extent to which physical volume of output continues to show strong and sustained growth.

## III. WAGE DEVELOPMENTS

Wage developments during 1958, at least in major collective bargaining situations, were more influenced by price developments and by wage increase commitments made in prior years than by the economic recession of 1957–58. The uncertainties of the early months of the year delayed some settlements and probably tended, in some cases, to reduce their size. However, many wage increases negotiated during the year were comparable with those in earlier years. Moreover, large groups of workers under long-term contracts received deferred wage increases and cost-of-living escalator increases, and the latter reflected the marked price rise that continued from 1957 into early 1958.

In many major collective bargaining situations, about half of the increase in wages during the year took the form of automatic cost-of-living escalator adjustments. In the basic steel industry, for example, the wage-rate increase effective in 1958 consisted of an average 8- to 9-cent deferred wage increase and a 9-cent cost-of-living adjustment. In the automobile industry, wage-rate increases aver-

[2] A bulletin providing detailed information on concepts, methods, and sources underlying these estimates, as well as an analysis of postwar trends in output per man-hour, will be available in about 1 month.

aging between 7 and 8 cents an hour were negotiated during the year and were supplemented by a 6-cent cost-of-living escalator advance.

Long-term agreements providing deferred increases, typically in combination with cost-of-living escalator clauses, have assumed substantial significance in recent years.[3] Hence, the economic outlook when these contracts are negotiated plays a major role in determining wage increases due in many key collective-bargaining situations for 1 to 4 years in the future; since the deferred increase provisions are usually accompanied by cost-of-living escalators the total increase effective in these situations also depends on the behavior of prices during the life of the contract. This willingness on the part of major groups of employers to make relatively long-run wage commitments seems related, in part, to their price and wage expectations. Presumably, it reflects confidence in the capacity of the economy to avoid a serious economic downturn, and the knowledge, in most cases, that competitors are similarly situated. It also represents a device for obtaining relative stability in labor relations over a period of 2 or more years.

However, it cannot be concluded (as some people have) that the net effect of these long-term contracts is to increase the total amount of wage increases going into effect over a period of years. There is an effect on the timing of wage adjustments, with wage rates rising more in recession periods than they otherwise might, and perhaps less in periods of buoyant activity.

Comparison of wage-rate increases in situations with escalator clauses and in those without such clauses does not indicate that over a period of years wage rates have risen more in industries where such clauses exist than where they have not been in effect. Factors other than automatic cost-of-living provisions apparently have had more bearing than escalation on the size of wage adjustments. The accompanying tables 3 and 4 trace general wage changes since 1948 in the basic steel industry, where cost-of-living escalator practices did not become effective until 1957; in automobiles, where escalation has been in effect since 1948; in rubber, which did not adopt a cost-of-living escalator during the period; in the building trades, where cost-of-living escalators are almost nonexistent; and in airframes.

The aircraft industry offers an unusual opportunity to contrast wage-rate changes under contracts with and without escalation. In west coast aircraft contracts with escalators, wage rates rose 15 or 16 cents more between mid-1956 and early 1958 than in other contracts in the industry. However, in the industry's 1958 bargaining, the workers in those situations without escalation—and whose wage rates therefore had lagged—received a catchup; it is certainly debatable whether they received this increase because the other workers had forged ahead, or whether the normal recognition of consumer price trends in bargaining would have resulted in such adjustments anyway—if not in 1958, at least in subsequent years.

Like deferred wage increase provisions, escalators may have had more effect on the timing of wage adjustments than on their magnitude over a period of years. Since prices paid by consumers, especially prices of foods and services, may continue to rise after economic activity slackens, and may not begin to advance as soon as business improves, the response of wage rates to changes in economic activity may be delayed somewhat by escalators. Escalator clauses increased the size of wage rate advances in 1958, but they may hold them down in 1959.

*Wage advances, 1958*

Altogether, preliminary figures for 1958 indicate that increases in wage rates were negotiated or put into effect during the year for about 6.8 million workers covered by major collective-bargaining agreements studied by the Bureau of Labor Statistics—or about four-fifths of all workers affected by these major agreements.[4] Almost half of these—approximately 3.3 million—received in-

[3] In recent years such agreements have been adopted in collective bargaining situations affecting more than 5 million workers, though in view of the fact these agreements expire in different years the number of workers eligible for deferred increases varies from year to year.

[4] This summary covers collective-bargaining situations affecting 1,000 or more workers and all industry groups except construction, the service trades, finance, and Government. Information on changes in union scales in the construction trades is presented in table 5. As this table indicates, about six out of seven of a group of union scales in the construction trades studied by the Bureau of Labor Statistics were increased during 1958, with nearly half rising at least 15 cents.

Among the industries in which wage rates were left unchanged during the year were petroleum refining, textiles, and men's apparel manufacture.

creases specified in contracts negotiated in earlier years; increases for the rest—about 3.5 million workers—were negotiated during 1958. A majority of those receiving deferred increases and a substantial proportion affected by negotiated raises also received cost-of-living escalator adjustments.

As chart 12 indicates, the most common increase during 1958, taking into account negotiated, deferred, and cost-of-living adjustments, averaged 12 cents an hour—about the same as in 1957. In some industries, notably basic steel and related industries and meatpacking, the raises were larger than in 1957; in the railroad industry the 1958 increase was below that for 1957. The differences in the magnitude of wage change between the 2 years in these industries reflects the timing of cost-of-living escalator adjustments.[5]

Turning from all wage changes whether negotiated or effective in 1958 to only those increases negotiated during the year, the median negotiated increase was 8 cents an hour This was about 2 cents smaller than the increases negotiated during 1957. With the prevalence of long-term agreements, however, the industries that bargain in any given year differ substantially from those bargaining in the next year, and, hence, it is not possible to draw significant conclusions from relatively small changes in the size of negotiated increases in successive years. For example, more of the negotiated increases may be supplemented by cost-of-living escalator increases in 1 year than in the next. (One of the major industries bargaining in 1958 was the automobile industry where cost-of-living escalator adjustments significantly supplemental the negotiated increases.) Adding cost-of-living adjustments to the negotiaed increases, the median advance for workers whose rates were raised by 1958 negotiations was 13 cents an hour, with almost half the workers affected by the year's negotiations receiving at least this amount.

There may have been some reduction between 1957 and 1958 in the size of the total wage and fringe benefit packages negotiated, though there are no data on fringe benefit expenditures that can be used to verify this conclusion. About three out of four of the major agreements negotiated in 1958, as in 1957, liberalized supplementary benefits, but there was some decline in the number of benefits that were changed by each contract. It is also possible, although data are not available to support this impression, that the recession had a greater influence on small collective bargaining settlements than on the major ones.

*Earnings trends*

Hourly earnings for all factory production workers were held down during most of the year by the relatively greater decline in employment in the higher wage durable goods industries than in nondurable goods production and by some decline in premium pay for overtime early in the year. Subsequently, there was some recovery in durable goods employment. Hours of work were also lengthened during the latter months of the year. Consequently, from December 1957 to December 1958, average hourly earnings of factory production workers rose about 4.3 percent while weekly earnings increased 6.4 percent, in both cases to an alltime high. (See chart 13.) Real weekly earnings advanced 4.6 percent—almost to their previous peak—as the Consumer Price Index leveled off during the latter months of the year. This contrasts with a decline of 4.5 percent in real weekly earnings during 1957, when hours fell and prices rose throughout the year. In nonmanufacturing hourly earnings changes varied from essentially no change in coal mining to increases of about 5 percent or more in electric and gas utilities, railroads, and communications. (See tables 6 and 7.)

*The 1959 outlook*

The year 1959 will be a heavy bargaining year, with many of the key long-term agreements subject to renegotiation or reopening. This means, of course, that fewer workers will receive predetermined increases and that makes prediction more difficult. Among the industries in which long-term contracts are subject to renegotiation or reopening during 1959 are basic steel, aluminum, nonferrous metals, meatpacking, east and gulf coast longshoring, and railroads; in addition, there will presumably be negotiations in such industries as petroleum refining,[6] rubber, and telephones, in which long-term agreements have not been negotiated.

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[5] The fact that in some industries cost-of-living adjustments were higher in 1958 than in 1957 but that in other industries they were lower is largely due to differences in the index months to which various cost-of-living escalators are tied.

[6] The first 1959 settlement in this industry, providing a 5-percent wage rate increase, was announced in mid-January. Most of the petroleum industry did not change wage rates during 1958.

While it is impossible to predict the precise outcome of these negotiations, wage rates clearly will continue to rise substantially, assuming no interruption to economic recovery. One significant factor in the wage outlook, however, is the fact that at least 4 million organized and 400,000 unorganized workers are covered by current arrangements for automatic changes in pay with changes in the Consumer Price Index.

Because this index has been relatively stable in recent months, the escalator adjustments in such industries as basic steel, aluminum, and meatpacking will be smaller in 1959 than they were in 1958. The semiannual escalator formulas in effect in these industries make any cost-of-living changes for 1959 dependent on price behavior from May 1958 to May 1959, assuming no change in the escalation formula. We already know that the index has been much more stable during most of this period than it was from May 1957 to May 1958. Thus, the cost-of-living increase in basic steel effective in January 1959 amounted to 1 cent, compared with 5 cents in January 1958. The Consumer Price Index would have to rise by 3 percent, or 3.7 index points, between January and May—much more rapidly than can reasonably be anticipated—if the cost-of-living increase in this industry were to equal the 9-cent cost-of-living adjustment effective in 1958.

Approximately 400,000 workers in the construction industry, and 2.5 million workers covered by major collective bargaining situations in other industries, will receive wage rate increases in 1959 that were specified in agreements concluded in earlier years. The size of these increases and their effective dates are indicated in tables 8, 9, and 10.

About two out of three construction workers due to receive deferred increases will have their scales advanced at least 15 cents. In other industries, almost 6 out of every 10 workers covered by provisions for deferred wage adjustments will have their basic pay scales raised an average of 6 but less than 8 cents an hour. The deferred increases due during 1959 in industries other than construction will apparently be smaller than those scheduled in 1958 on the average. This difference is due, however, to the fact that different industries are affected in each of the 2 years rather than to any reduction in the size of the deferred increases negotiated within the same industry. These pay increases do not include any cost-of-living escalator adjustments; such adjustments are rare in construction but, as table 11 indicates, almost two out of three workers in other industries due to receive deferred increases are also covered by cost-of-living escalator provisions.

## IV. PRICE DEVELOPMENTS

The two major price measures—the Wholesale Price Index and the Consumer Price Index—rose moderately during most of the recession, but have held steady since the economic upturn began in late spring. Between June and December 1958, neither of the two series fluctuated by more than two-tenths of an index point. For the year as a whole, they have also been relatively stable; wholesale prices ended the year only 0.6 percent higher than a year earlier, and consumer prices were up by 1.7 percent for a much smaller December-to-December rise than in the 2 previous years. (See charts 14 to 17.)

The recent stability reflects a wide variety of increases and decreases within the overall indexes. Looking at the various components of the indexes, we see several notable, but not especially surprising, developments.

Dominating the trend, and moving virtually independently of the business cycle, have been the prices of farm and food products; these rose most sharply at the very time the recession was most pronounced and then declined at midyear, after business activity had begun to improve. Changing supply conditions were the major factor. Prices of farm products, which have a relative weight of almost 11 percent in the Wholesale Price Index, reached a post-Korea high in March 1958, 10 percent above the previous September, largely as a result of reduced marketings of livestock and severe weather damage to fruit and vegetable crops. (See chart 14.) However, steady declines occurred in subsequent months as the result of plentiful crops, increasing supplies of hogs and poultry, and a sharp drop in wool prices, so that farm prices by December were 2.1 percent lower than a year earlier. Processed foods, on the other hand, with a weight of almost 13 percent in the Wholesale Price Index, continued to rise in price to reach an alltime high at midyear; they then slipped back by December, showing a price rise of 1.3 percent over the year. At the retail level, food prices, which comprise nearly 29 percent of the index, also moved upward to a new high in the spring and summer of 1958, and then fell slightly in the fall as supplies of meats and fresh vegetables became plentiful; in December, the food index was still 2.2 percent higher than a year earlier, and at high for the month. (See chart 16.)

Another significant factor, although not a new one, in the year's price developments was the continuing uptrend in the cost of consumer services, which constitute more than a third of the Consumer Price Index. These rose 2.5 percent in the past year, with some types of services, such as transportation and medical care, going up at twice that pace, as a result of sharp increases in such items as hospitalization insurance premiums, hospital room rates, local transit fares, and automobile insurance premiums. (See chart 17.) The previous year's rise was 4.2 percent, however. In recent months, rent and some other services seem to have been rising somewhat more slowly than they had earlier.

Prices of services have either held steady or risen since 1935, except for two brief periods, but still they have risen less as a whole, in the past two decades, than have commodities. (See table 12.) Within the services category, however, the medical care, transportation, and a variety of other types, have by now risen more rapidly in price since 1939 than have the nonfood commodities; only rent and the household operation services (especially gas and electricity) are still well behind the other groups, as compared to their 1939 levels.

Among the nonfarm commodities, developments were extremely mixed, but on the whole prices of manufactured goods were unchanged over the period, although edging upward in the latter half of 1958; on the other hand, prices of some of the industrial raw materials fluctuated widely, being much more sensitive to business conditions, both here and abroad. (See charts 15 and 16.)

The average of all commodities in the Wholesale Price Index, other than farm products and foods, was at a record high in December, some 0.9 percent above a year earlier; the year-to-year increase was slightly less than it was a year ago, and only a fourth as much as in the 2 preceding years. Of the 13 groups within this category, declines were experienced by 4. The fuel, power, and lighting materials group declined, reflecting drops in coal and peroleum products prices, although gas prices have gone up sharply; textile products and apparel averages fell, with silk and wool products down sharply, cotton products off slightly, and apparel prices quite steady; and there were small declines in the chemicals and allied products group (particularly fats and oils) and in furniture and other household durables.

Sizable year-to-year increases, averaging from 1.4 to 4.1 percent, have occurred in the leather, lumber, metals, and machinery groups, reflecting in most cases increasing demand toward the end of the year. Machinery prices have been rising since September, after 9 months of stability, with rises chiefly in farm and construction machinery; similarly, lumber prices reached in March the lowest level since July 1950, but recovered some 3½ percent by the year-end as housing activity expanded.

At the retail end, prices of commodities other than foods rose only 0.7 percent during the year, with nondurables declining by 0.3 percent and the durables (other than automobiles) showing no change. New-car prices, however, averaged 6.2 percent higher in December 1958 than a year earlier. This compares with an increase of 2 percent a year ago; the difference results from larger increases in factory prices of popular models this year than last, and also from the fact that thus far there has been relatively little discounting of the 1959 models.

Assessing the significance of the 1958 price trends, requires taking into account a wide variety of short-run factors, especially limited supplies of some foods, and long-run factors, notably a steadily rising demand for services of the kind which are not subject to the productivity gains which characterize the production of commodities. It is also necessary to bear in mind that prices are slower than other economic indicators to reflect the turns of the business cycle, with consumer prices generally even slower than wholesale commodity prices; except in times of great stress, our price measures consequently fail to change as rapidly as does business activity. There is some evidence moreover, that many prices have now become even less flexible on the downside than in earlier periods of recession, but this is a point which needs more investigation before one can draw any positive conclusions. One factor in maintaining prices during the past year, not generally recognized, has been the fact that, as indicated in the section on unemployment, consumer incomes were better maintained than in earlier recessions.

*Prospects*

Price movements, both wholesale and retail, have in recent months followed two divergent trends—a substantial downtrend resulting from the improved supply of foods as compared with last spring, and a fair amount of stability (with a tendency to move upward lately) in the prices of most raw materials and manufactured goods.

Agricultural and food prices have perhaps declined somewhat more than had been expected and should continue to provide further moderate declines in the coming months, assuming that weather conditions are reasonably favorable. On the other hand, there appears to be every likelihood that the cost of services will continue to rise. In addition the maintenance of the present pace of business recovery will probably exert new upward pressures on industrial prices. Thus, it seems fairly clear that the opposing force of declining food prices and rising costs of services and some industrial items will tend to offset each other in the immediate future, keeping the indexes relatively stable.

For the rest of 1959, however, prices will continue to follow other important indicators, assuming normal weather. Their major determinant in the short run will be such factors as the strength of demand, the rapidity of the recovery, the results of labor-management negotiations, and the availability of money and credit.

## V. TRENDS IN CONSTRUCTION

*Construction expenditures in 1958*

Expenditures for construction set a new record of $49 billion in 1958. Increased spending for residential building and highways were major developments contributing to the 2-percent gain over 1957 (chart 18). In terms of physical volume (expenditures adjusted for changes in construction costs), however, new construction continued at about the 1956–57 level, which was slightly below the peak achieved in 1955.

The year 1958 was the first since 1949 in which total private construction expenditures failed to show an over-the-year increase, primarily because of curtailed industrial building programs. Gains in other types of private building were sufficient, however, to keep the private total close to the 1957 record of $34 billion. In addition to the upswing in housing, private outlays advanced to new highs in 1958 for office buildings and warehouses, schools, and hospitals. Spending for privately owned public utilities remained near 1957's record level, but 1958 expenditures for new stores showed another over-the-year decline from their 1956 peak, despite a strong upturn after mid-year.

Public expenditures for new construction climbed 6 percent to a record $15 billion in 1958. All of the $100-million gain in public construction in 1958 was from Federal funds, with the largest share of the increase in grants-in-aid for highways. Gains in this type of construction reflect continued expansion of work on the Interstate Highway System, authorized by the Federal-Aid Highway and Revenue Act of 1956. Some of the 1958 rise in highway expenditures—to a record $5.4 billion—was traceable to the Federal-Aid Highway Act of 1958, which authorized substantial increases in funds for the regular Federal-aid program as well as additional amounts for the Federal-aid Interstate System and for federally owned highways and roads. To some extent, however, the expanded activity on the Federal-aid highway programs in 1958 was offset by the continued downtrend in highway construction financed solely by State agencies (chart 19). This decline, which began in 1957, reflected the virtual cessation of toll-road construction.

Housing programs also contributed a substantial share to the 1957–58 rise in public construction expenditures. The total of 67,000 units of public housing started in 1958 was the largest begun in any year since 1951. Most of the increase was to provide housing at military installations under the Capehart program, which accounted for more than half of the public housing begun in 1958, but there was also some expansion in low-rent projects under State and local housing programs.

Public expenditures also edged up to new highs in 1958 for schools ($2.9 billion) and for conseravtion and development projects ($1 billion). Primarily because of work done on new post offices and other Federal office buildings, outlays for administrative and service buildings expanded (for the sixth consecutive year) to more than half a billion dollars. Public hospital and institutional building showed another substantial rise in 1958, after reversing a 5-year downtrend in 1957. Public industrial building dropped sharply over the year, however, and military construction continued the decline which began in 1957.

*Housing in 1958*

Residential construction was an expansive influence in 1958, as it was in 1954. Private residential expenditures, after declining (on a seasonally adjusted basis) to the lowest level in 4 years in the spring of 1958, rebounded to record heights at the year's end. The rise in residential expenditures reflected primarily the substantial gains in housing starts beginning in April, as well as some increase in construction costs.

The strong pickup in housing to an annual total of 1,200,000 starts for 1958 was on a broad front: gains over 1957 occurred in private as well as public housing, in metropolitan and nonmetropolitan areas, and in all geographic regions of the country. Single-family housing reversed a 2-year downtrend, and apartment construction continued to rise sharply in 1958, approaching the postwar record volume of 1949–50 for this rental-type housing.

The increase in private housing starts in 1958—like the large decline of preceding years—was mainly in units financed under federally underwritten programs (chart 20). The flow of credit for FHA-insured and VA-guaranteed mortgages increased in response to the general easing in credit markets during the recession, and to legislative and administrative measures taken in 1957 and 1958—especially the Emergency Housing Act of 1958 which was approved early in April.

Supported by easing credit conditions, as well as by provisions of the new law, applications for FHA-insured loans for new construction soared in 1958 to the highest level since the 1950 peak. Private housing starts moved up sharply in response, and FHA-assisted housing accounted for 26 percent of the privately financed starts in 1958, compared with 17 percent in 1957.

Requests for VA appraisals also rose substantially, but not so spectacularly as FHA applications in 1958. Despite notable gains in the latter part of the year, the annual total of housing starts under the VA program was 20 percent lower in 1958 than in 1957, and the VA share of all new private housing dropped from 13 percent in 1957 to 9 percent in 1958.

Conventionally financed housing starts rose 5 percent over 1957. In times of strong demands for credit, conventional mortgages maintain a better competitive position in relation to alternative investment outlets than do federally underwritten mortgages. This observation is supported by the data in chart 20, which show that the number of private housing starts financed under conventional arrangements has remained comparatively steady at a high level in recent years when the demands for credit have fluctuated widely.

*The outlook for 1959*

Spending for new construction as a whole will provide a substantial upward thrust to the 1959 economy. Dollar volume will probably rise to a new high of about $52 billion. The physical volume of work put in place will also rise above the peak reached in 1955, although construction costs are expected to rise moderately. Private construction will resume its upward trend in 1959—chiefly because of a large increase in expenditures for housing—and public work will continue to rise (chart 21). Well over half the advance in public work in 1959 will be financed by the Federal Government, as programs initiated as antirecession measures in 1958 gather momentum.

Despite increased demands for credit from other sectors of the economy which are anticipated in 1959 as the Nation's total output of goods and services expands, it is expected that funds for construction will be generally adequate. However, money for home mortgages probably will become less readily available at the comparatively low downpayments and interest rates prevailing in 1958. Also, in the present legislative framework, it is anticipated that the seasonally adjusted annual rate of private housing starts will continue at a relatively high level in the early months of 1959 and will taper off thereafter. Thus, the present outlook is for only a small rise in housing starts above the 1,200,000 units (public and private) which were placed under construction in 1958. Partly because of the carryover of work begun in 1958, however, the rise in expenditures for private housing is likely to be substantially greater than would be indicated by the moderate increase foreseen in the dwelling units to be started.

The increase in new private housing outlays also anticipates that the average construction cost per unit will rise. Among the considerations leading to this conclusion is that, under the less favorable mortgage terms in prospect for 1959, and as builders use up the relatively large volume of 1958 commitments for moderate-cost houses with Government-backed mortgages, the proportion of higher priced single-family houses may be expected to increase.

For private nonresidential construction expenditures as a whole, a decrease is expected for the second successive year, due primarily to a further decline in industrial building. The 1959 outlook varies for individual types of private nonresidential construction, however, with gains in prospect for shopping facilities, churches, and schools.

Expenditures for all types of public construction are expected to rise in 1959, with the major impetus supplied by the Federal Government. Antirecession measures and reevaluation of defense programs have resulted in acceleration of projects, rising contract awards, and large appropriations during 1958, which will cause sizable increases in the amounts spent on direct Federal and Federal-aid construction in 1959.

About a third of the increase in public expenditures will be for highways, which form the largest single type of public construction. Gains in 1959 will reflect accelerated activity on the interstate Federal-aid highway program and, particularly, the additional $400 million for the regular Federal-aid highway program, provided under the Federal-Aid Highway Act of 1958 for work to be done during 1959.

Outlays for public schools will continue to show only a small gain. This type of building, second in importance only to highways in dollar volume, should reach the $3 billion level for the first time, but will account for a somewhat smaller proportion of total public construction expenditures in 1959 than in recent years.

Expenditures for military facilities are expected to rise in 1959, following a 2-year decline. This expansion will be chiefly for construction of long-range ballistic missile bases and dispersal bases for the Strategic Air Command. The small gain foreseen in public expenditures for industrial construction is to expand missile production facilities by the military and does not reflect the substantial increase in the 1959 appropriations for reactors and other facilities to be constructed by the Atomic Energy Commission, which require a long leadtime.

TABLE 1.—*Deviation of actual from trend[1] labor force, by age and sex, annual average 1951–58*

[In thousands]

| Age and sex | 1950 Actual labor force [2] | 1951 Actual labor force [2] | 1951 Trend labor force | 1951 Deviation of actual from trend | 1952 Actual labor force [2] | 1952 Trend labor force | 1952 Deviation of actual from trend |
|---|---|---|---|---|---|---|---|
| Total, 14 and over | 65,135 | 66,401 | 65,942 | 459 | 66,977 | 66,706 | 271 |
| Male, 14 and over | 46,417 | 47,072 | 46,828 | 244 | 47,391 | 47,186 | 205 |
| 14 to 24 | 8,474 | 8,586 | 8,419 | 167 | 8,510 | 8,383 | 127 |
| 25 to 64 | 35,348 | 35,878 | 35,771 | 107 | 36,342 | 36,124 | 218 |
| 65 and over | 2,595 | 2,608 | 2,638 | −30 | 2,539 | 2,679 | −140 |
| Female, 14 and over | 18,718 | 19,329 | 19,114 | 215 | 19,586 | 19,520 | 66 |
| 14 to 24 | 4,675 | 4,683 | 4,622 | 61 | 4,513 | 4,583 | −70 |
| 25 to 64 | 13,427 | 14,064 | 13,843 | 221 | 14,453 | 14,255 | 198 |
| 65 and over | 616 | 582 | 649 | −67 | 620 | 682 | −62 |

| Age and sex | 1953 Actual labor force | 1953 Trend labor force | 1953 Deviation of actual from trend | 1954 Actual labor force | 1954 Trend labor force | 1954 Deviation of actual from trend | 1955 Actual labor force | 1955 Trend labor force | 1955 Deviation of actual from trend |
|---|---|---|---|---|---|---|---|---|---|
| Total, 14 and over | 67,362 | 67,417 | −55 | 67,818 | 68,144 | −326 | 68,896 | 68,854 | 42 |
| Male, 14 and over | 47,692 | 47,528 | 164 | 47,847 | 47,832 | 15 | 48,054 | 48,108 | −54 |
| 14 to 24 | 8,423 | 8,342 | 81 | 8,257 | 8,303 | −46 | 8,229 | 8,261 | −32 |
| 25 to 64 | 36,729 | 36,454 | 275 | 37,065 | 36,778 | 287 | 37,299 | 37,052 | 247 |
| 65 and over | 2,544 | 2,732 | −188 | 2,525 | 2,751 | −226 | 2,525 | 2,795 | −270 |
| Female, 14 and over | 19,668 | 19,889 | −221 | 19,971 | 20,312 | −341 | 20,842 | 20,746 | 96 |
| 14 to 24 | 4,399 | 4,546 | −147 | 4,380 | 4,530 | −150 | 4,445 | 4,541 | −96 |
| 25 to 64 | 14,571 | 14,619 | −48 | 14,925 | 15,028 | −103 | 15,617 | 15,410 | 207 |
| 65 and over | 693 | 724 | −31 | 666 | 754 | −88 | 779 | 795 | −16 |

| Age and sex | 1956 Actual labor force | 1956 Trend labor force | 1956 Deviation of actual from trend | 1957 Actual labor force | 1957 Trend labor force | 1957 Deviation of actual from trend | 1958 Actual labor force | 1958 Trend labor force | 1958 Deviation of actual from trend |
|---|---|---|---|---|---|---|---|---|---|
| Total, 14 and over | 70,387 | 69,692 | 695 | 70,746 | 70,681 | 65 | 71,284 | 71,538 | −254 |
| Male, 14 and over | 48,579 | 48,360 | 219 | 48,649 | 48,792 | −143 | 48,802 | 49,115 | −313 |
| 14 to 24 | 8,424 | 8,235 | 189 | 8,450 | 8,379 | 71 | 8,476 | 8,543 | −67 |
| 25 to 64 | 37,552 | 37,595 | −43 | 37,721 | 37,875 | −154 | 37,948 | 38,036 | −88 |
| 65 and over | 2,603 | 2,530 | 73 | 2,477 | 2,538 | −61 | 2,379 | 2,536 | −157 |
| Female, 14 and over | 21,808 | 21,332 | 476 | 22,087 | 21,889 | 208 | 22,482 | 22,423 | 59 |
| 14 to 24 | 4,648 | 4,454 | 194 | 4,651 | 4,526 | 125 | 4,681 | 4,597 | 84 |
| 25 to 64 | 16,338 | 16,070 | 268 | 16,633 | 16,517 | 116 | 16,980 | 16,950 | 30 |
| 65 and over | 821 | 808 | 13 | 813 | 846 | −33 | 822 | 876 | −54 |

[1] Trend labor forces for 1951–55 are projections made in 1951 based on 1920–50 trends in age-sex labor force participation rates with an adjustment in the rates for adult women to take account of accelerated increases observed in 1947–50. Trend labor forces for 1956–58 are based on 1947–56 trends in labor force participation rates by age and sex, by school enrollment for young persons, and by marital and child status for adult women.

[2] The actual labor force estimates for 1950, 1951, and 1952 are based on revised population estimates and therefore differ from published Census figures for the same dates.

NOTE.—Figures may not add to totals because of rounding.

Source: U.S. Bureau of the Census and Bureau of Labor Statistics.

Prepared by: U.S. Department of Labor, Bureau of Labor Statistics, Division of Manpower and Employment Statistics, Jan. 19, 1959.

TABLE 2.—*Indexes of real product per man-hour for the private economy, 1947–58*

[1947–49=100]

| Year | Man-hour estimates based primarily on data from— | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Bureau of Labor Statistics | | | | | Bureau of the Census | | |
| | Total | Agriculture | Nonagricultural industries | | | Total | Agriculture | Nonagricultural industries |
| | | | Total | Manufacturing | Nonmanufacturing | | | |
| 1947 | 96.7 | 90.5 | 97.5 | 97.6 | 97.3 | 97.4 | 90.6 | 98.4 |
| 1948 | 100.2 | 107.1 | 99.4 | 100.1 | 98.9 | 100.3 | 107.5 | 99.4 |
| 1949 | 103.1 | 102.2 | 103.3 | 102.6 | 103.9 | 102.2 | 101.6 | 102.4 |
| 1950 | 110.4 | 116.2 | 108.8 | 109.5 | 108.4 | 110.3 | 116.1 | 108.5 |
| 1951 | 113.2 | 114.6 | 110.6 | 111.2 | 110.0 | 115.2 | 114.1 | 112.8 |
| 1952 | 115.7 | 124.5 | 112.0 | 113.0 | 111.3 | 118.9 | 124.0 | 115.5 |
| 1953 | 120.4 | 138.6 | 115.1 | 118.3 | 112.8 | 123.9 | 138.0 | 119.0 |
| 1954 | 122.6 | 148.3 | 116.9 | 117.4 | 116.7 | 127.0 | 147.9 | 121.8 |
| 1955 | 128.0 | 153.3 | 121.9 | 125.6 | 120.0 | 133.1 | 152.9 | 127.5 |
| 1956 | 128.8 | 160.7 | 121.8 | 127.1 | 119.1 | 134.2 | 160.2 | 127.7 |
| 1957 | 132.3 | 168.6 | 124.4 | 127.7 | 122.9 | 137.8 | 168.6 | 130.0 |
| 1958 [1] | 133.4 | 190.1 | 124.3 | (2) | (2) | 137.6 | 190.1 | 128.6 |

[1] Preliminary, subject to revision.
[2] Not available.

NOTE.—The indexes in this table were computed by Department of Labor, Bureau of Labor Statistics, from estimates of real product and man-hours. The real product estimates, referring to 1954 prices, are based primarily on national product statistics of the Department of Commerce, Office of Business Economics, except for the manufacturing real product estimates which were developed by the Bureau of Labor Statistics.

Output per man-hour estimates based primarily on Bureau of Labor Statistics man-hour data relate, in concept, to man-hours paid whereas estimates based primarily on Bureau of the Census labor force data relate, in concept, to hours worked. The difference between the 2 measures may, however, be due in part to statistical as well as conceptual differences. Both sets of man-hour estimates cover the man-hours of wage and salary workers, self-employed and unpaid family workers.

Concepts, methods, and sources are described in forthcoming BLS report, "Postwar Trends in Output Per Man-Hour, Total Private Economy and Major Sectors."

TABLE 3.—*General wage increases (cumulative) from January 1948 to December 1958 in selected major collective bargaining situations*

| Year | General Motors [1] | | Basic steel (United States Steel [2]) | | Airframes (Lockheed [3]) Southern California | | Airframes (North American [4]) | | Rubber (Firestone and B. F. Goodrich [5]) | | Building trades [6] | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Cents | Estimated percent | Cents | Estimated percent | Cents | Estimated percent | Cents | Estimated percent | Cents | Estimated percent | Cents | Estimated percent |
| January 1948 to December of— | | | | | | | | | | | | |
| 1948 | 14.0 | 9.4 | 13.0 | 8.6 | 5.0 | 3.7 | 10.0 | 7.3 | 11.0 | 6.8 | 20.0 | 10.0 |
| 1949 | 14.0 | 9.4 | 13.0 | 8.6 | 17.0 | 12.5 | 15.0 | 11.0 | 11.0 | 6.8 | 25.0 | 12.5 |
| 1950 | 24.5 | 16.5 | 29.0 | 19.3 | 27.0 | 19.8 | 24.0 | 17.6 | 22.5 | 14.0 | 40.0 | 20.0 |
| 1951 | 38.5 | 25.9 | 29.0 | 19.3 | 40.0 | 29.4 | 35.0 | 25.7 | 35.5 | 22.1 | 50.0 | 25.0 |
| 1952 | 46.5 | 31.3 | 46.2 | 30.7 | 50.0 | 36.7 | 50.0 | 36.7 | 45.5 | 28.3 | 65.0 | 32.5 |
| 1953 | 54.5 | 36.7 | 54.7 | 36.4 | 58.0 | 42.6 | 57.5 | 42.2 | 48.2 | 30.0 | 76.0 | 38.0 |
| 1954 | 57.5 | 38.7 | 60.9 | 40.5 | 63.1 | 46.3 | 62.5 | 45.9 | 54.7 | 34.0 | 87.0 | 43.5 |
| 1955 | 67.7 | 45.6 | 76.1 | 50.6 | 63.1 | 46.3 | 62.5 | 45.9 | 68.7 | 42.7 | 96.9 | 48.5 |
| 1956 | 79.8 | 53.7 | 86.6 | 57.6 | 73.9 | 54.3 | 75.5 | 55.4 | 74.9 | 46.6 | 110.5 | 55.3 |
| 1957 | 91.9 | 61.9 | 102.7 | 68.3 | 80.9 | 59.4 | 91.5 | 67.2 | 89.4 | 55.6 | 125.5 | 62.8 |
| 1958 | 105.9 | 71.3 | 120.8 | 80.4 | 101.65 | 74.6 | 100.25 | 73.6 | 97.4 | 60.5 | [7] 140.0 | [7] 70.0 |

[1] Escalator clause put into effect in September 1948.
[2] Escalator clause effective first pay period of 1957.
[3] Escalator clause effective from late 1952 to end of 1954 and reestablished effective September 1958.
[4] Escalator clause effective in 1951.
[5] No escalator clause.
[6] Practically no escalator clauses in industry.
[7] As of Jan. 1, 1959.

NOTE.—Figures are estimates since it was necessary to convert cents and percentage raises to a common base and to put a value on inequity adjustments.

TABLE 4.—*General wage increase*[1] *(cents per hour) from January 1948, to December 1958, in selected major collective bargaining situations*

| Year | General Motors | | Basic steel (United States Steel) | | Airframes (Lockheed) Southern California | | Airframes (North American) | | Rubber (Firestone and B. F. Goodrich) | | Building trades | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Total | Due to cost of living | Total | Due to cost of living | Total | Due to cost of living | Total | Due to cost of living | Total | Due to cost of living | Total | Due to cost of living |
| 1948 | 14.0 | 8 | 13.0 | (2) | 5 | (2) | 10 | (2) | 11.0 | (2) | 20.0 | (2) |
| 1949 | 0 | −3 | 0 | (2) | 12 | (2) | 5 | (2) | 0 | (2) | 5.0 | (2) |
| 1950 | 10.5 | 6 | 16.0 | (2) | 10 | (2) | 9 | (2) | 11.5 | (2) | 15.0 | (2) |
| 1951 | 14.0 | 10 | 0 | (2) | 13 | (2) | 11 | 11 | 13.0 | (2) | 10.0 | (2) |
| 1952 | 8.0 | 4 | 17.2 | (2) | 10 | 1 | 15 | 5 | 10.0 | (2) | 15.0 | (2) |
| 1953 | 8.0 | 2 | 8.5 | (2) | 8 | 3 | 7.5 | −1 | 2.7 | (2) | 11.0 | (2) |
| 1954 | 3.0 | −2 | 6.2 | (2) | 5.1 | −1 | 5 | 0 | 6.5 | (2) | 11.0 | (2) |
| 1955 | 10.2 | 1 | 15.2 | (2) | 0 | (2) | 0 | 0 | 14.0 | (2) | 9.9 | (2) |
| 1956 | 12.1 | 6 | 10.5 | (2) | 10.8 | (2) | 13 | 3 | 6.2 | (2) | 13.6 | (2) |
| 1957 | 12.1 | 6 | 16.1 | 7 | 7 | (2) | 16 | 9 | 14.5 | (2) | 15.0 | (2) |
| 1958 | 14.0 | 6 | 18.1 | 9 | [3] 20.75 | 1 | 8.75 | 5 | 8.0 | (2) | [4] 14.5 | (2) |
| Total (1948–58) | 105.9 | 44 | 120.8 | 16 | 101.65 | 4 | 100.25 | 32 | 97.4 | (2) | 140.0 | (2) |

[1] Except when preceded by a minus sign.
[2] No cost-of-living clause.
[3] In May 1958, Lockheed reestablished escalator clause—figure reported includes 16 cents cost-of-living catchup and estimated 3.75-cent general wage increase.
[4] As of Jan. 1, 1959.

NOTE.—Total figures are estimates since it was necessary to convert cents and percentage raises to a common base and to put a value on inequity adjustments.

TABLE 5.—*Changes in union wage scales in seven construction trades in major cities,[1] 1958 and 1957*

| Cents-per-hour increases | Percentage of scales in— | |
|---|---|---|
| | 1958 | 1957 |
| All scales | [2] 100 | [2] 100 |
| All increases | 87 | 89 |
| Under 5 | 1 | 1 |
| 5 and under 10 | 8 | 7 |
| 5 | 2 | 2 |
| 7.5 | 3 | 2 |
| 10 and under 15 | 33 | 30 |
| 10 | 19 | 17 |
| 12.5 | 9 | 10 |
| 15 and under 20 | 24 | 26 |
| 15 | 20 | 18 |
| 20 and under 25 | 11 | 12 |
| 20 | 9 | 8 |
| 25 and over | 12 | 13 |
| 25 | 7 | 10 |
| No change | 13 | 12 |

[1] The 7 trades studied were bricklayers, carpenters, electricians, painters, plasterers, plumbers, and building laborers.
[2] Because of rounding, sums of individual items do not necessarily equal the totals.

TABLE 6.—*Average hourly earnings of factory production workers by industry group, December 1958[1] and December 1957*

| Industry | Average hourly earnings | | | | Percentage increase December 1957 to December 1958[1] | |
|---|---|---|---|---|---|---|
| | December 1958[1] | | December 1957 | | | |
| | Including premium pay for overtime | Excluding premium pay for overtime | Including premium pay for overtime | Excluding premium pay for overtime | Including premium pay for overtime | Excluding premium pay for overtime |
| All manufacturing | $2.19 | $2.12 | $2.10 | $2.05 | 4.3 | 3.4 |
| Durable goods | 2.35 | 2.28 | 2.24 | 2.19 | 4.9 | 4.1 |
| Nondurable goods | 1.97 | 1.91 | 1.92 | 1.86 | 2.6 | 2.7 |
| Ordnance and accessories | 2.54 | 2.48 | 2.42 | 2.37 | 5.0 | 4.6 |
| Food and kindred products | 2.05 | 1.98 | 1.97 | 1.90 | 4.1 | 4.2 |
| Tobacco manufactures | 1.66 | 1.62 | 1.54 | 1.51 | 7.8 | 7.3 |
| Textile mill products | 1.52 | 1.47 | 1.50 | 1.46 | 1.3 | .7 |
| Apparel and other finished textile products | 1.52 | 1.49 | 1.50 | 1.48 | 1.3 | .7 |
| Lumber and wood products | 1.91 | 1.84 | 1.83 | 1.78 | 4.4 | 3.4 |
| Furniture and fixtures | 1.80 | 1.74 | 1.77 | 1.72 | 1.7 | 1.2 |
| Paper and allied products | 2.15 | 2.05 | 2.08 | 1.99 | 3.4 | 3.0 |
| Printing | 2.65 | | 2.54 | | 4.3 | |
| Chemicals and allied products | 2.36 | 2.30 | 2.26 | 2.21 | 4.4 | 4.1 |
| Products of petroleum and coal | 2.77 | 2.72 | 2.73 | 2.68 | 1.5 | 1.5 |
| Rubber products | 2.45 | 2.35 | 2.31 | 2.25 | 6.1 | 4.4 |
| Leather and leather products | 1.59 | 1.56 | 1.56 | 1.53 | 1.9 | 2.0 |
| Stone, clay and glass products | 2.16 | 2.08 | 2.10 | 2.03 | 2.9 | 2.5 |
| Primary metal industries | 2.75 | 2.69 | 2.55 | 2.51 | 7.8 | 7.2 |
| Fabricated metal products | 2.33 | 2.25 | 2.22 | 2.16 | 5.0 | 4.2 |
| Machinery (except electrical) | 2.44 | 2.37 | 2.34 | 2.29 | 4.3 | 3.5 |
| Electrical machinery | 2.20 | 2.14 | 2.11 | 2.08 | 4.3 | 2.9 |
| Transportation equipment | 2.66 | 2.55 | 2.48 | 2.42 | 7.3 | 5.4 |
| Instruments and related products | 2.24 | 2.18 | 2.14 | 2.09 | 4.7 | 4.3 |
| Miscellaneous manufacturing industries | 1.87 | 1.81 | 1.83 | 1.78 | 2.2 | 1.7 |

[1] Preliminary.

TABLE 7.—*Average hourly earnings in selected nonmanufacturing industries, November 1958* [1] *and November 1957*

| Industry | Average hourly earnings | | Percentage change, November 1957 to November 1958 [1] |
|---|---|---|---|
| | November 1958 [1] | November 1957 | |
| Mining: | | | |
| Metal | $2.55 | $2.46 | 3.7 |
| Anthracite | 2.61 | 2.65 | −1.5 |
| Bituminous coal | 3.03 | 3.05 | −0.7 |
| Contract construction | 3.03 | 2.96 | 2.4 |
| Nonbuilding construction | 2.72 | 2.70 | .7 |
| Building | 3.13 | 3.03 | 3.3 |
| General contractors | 2.91 | 2.83 | 2.8 |
| Special trade contractors | 3.26 | 3.15 | 3.5 |
| Class I railroads | 2.56 | 2.40 | 6.7 |
| Local railways | 2.14 | 2.07 | 3.4 |
| Communication: | | | |
| Telephone | 2.08 | 1.98 | 5.1 |
| Telegraph | 2.24 | 2.09 | 7.2 |
| Other public utilities: Gas and electric utilities | 2.52 | 2.38 | 5.9 |
| Wholesale and retail trade: | | | |
| Wholesale trade | 2.19 | 2.14 | 2.3 |
| Retail trade | 1.71 | 1.66 | 3.0 |
| Service and miscellaneous: | | | |
| Laundries | 1.14 | 1.11 | 2.7 |
| Cleaning and dyeing plants | 1.34 | 1.31 | 2.3 |

[1] Preliminary.

TABLE 8.—*Deferred wage increases* [1] *scheduled to go into effect in 1959 in situations affecting 1,000 or more workers in manufacturing and selected nonmanufacturing industries* [2]

| Average deferred wage increase (cents per hour) | Number of situations | Approximate number of workers affected (in thousands) | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | All industries studied [2] | Total manufacturing [3] | Food and kindred products | Printing and publishing | Chemicals and allied products | Stone, clay and glass products | Metalworking [4] | Total nonmanufacturing industries studied [2] | Mining | Warehousing, wholesale and retail trade | Transportation | Public utilities |
| Total | 348 | 2,472 | 1,680 | 65 | 28 | 19 | 40 | 1,450 | 792 | 181 | 136 | 423 | 52 |
| Under 5 cents | 27 | 129 | 46 | 1 | 3 | | 1 | 14 | 83 | | 40 | 13 | 30 |
| 5 but less than 6 cents | 61 | 412 | 381 | 8 | | 7 | 2 | 352 | 31 | | 13 | 18 | |
| 6 but less than 7 cents | 71 | 819 | 796 | 2 | | 2 | 26 | 752 | 23 | | 12 | 11 | |
| 7 but less than 8 cents | 74 | 583 | 287 | 9 | 3 | | 2 | 264 | 296 | | 33 | 262 | |
| 8 but less than 9 cents | 31 | 61 | 36 | | 10 | 7 | | 13 | 25 | 1 | 4 | 16 | 4 |
| 9 but less than 10 cents | 7 | 10 | 5 | 3 | | | | 2 | 6 | | 4 | 2 | |
| 10 but less than 11 cents | 33 | 157 | 62 | 15 | 2 | | | 40 | 95 | | 15 | 77 | 3 |
| 11 but less than 12 cents | 10 | 25 | 15 | 15 | | | | | 10 | | 3 | | 7 |
| 12 but less than 13 cents | 7 | 25 | 13 | 3 | | | 10 | | 12 | | 3 | 2 | 8 |
| 13 cents and over | 16 | 222 | 28 | 9 | 10 | | | 6 | 194 | 180 | 4 | 10 | |
| Amount not specified or not computed [5] | 11 | 27 | 11 | | | 2 | | 8 | 17 | | 5 | 12 | |

[1] Excluding any cost-of-living-adjustments.

[2] Excludes certain industries, notably construction, the service trades, finance, and government.

[3] Includes a few settlements in the following industry groups for which separate data are not provided: Tobacco (4,000 workers), textiles (1,000), apparel (7,000), paper (5,000), rubber (6,000), footwear (26,000), and miscellaneous manufacturing (11,000).

[4] Metalworking employees are found primarily in the manufacture of automobiles, automobile parts, farm equipment, aircraft, and electrical products.

[5] Insufficient information to compute cents-per-hour increases.

NOTE.—Because of rounding, sums of individual items may not equal totals.

TABLE 9.—*Deferred increases in union scales scheduled to go into effect in 1959 in major situations in construction*

| Hourly increases effective during period | Approximate number of workers affected | | |
|---|---|---|---|
| | Total for 1959 [1] | Jan. 1 to June 30 | July 1 to Dec. 31 |
| Total | 397,000 | 378,000 | 122,500 |
| 5 but less than 7 cents | 25,500 | 25,500 | 12,000 |
| 7 but less than 9 cents | 22,000 | 12,000 | 10,000 |
| 9 but less than 11 cents | 61,500 | 165,000 | 11,000 |
| 11 but less than 13 cents | 16,000 | 16,000 | |
| 13 but less than 15 cents | 12,000 | 12,000 | |
| 15 but less than 17 cents | 105,500 | 93,500 | |
| 17 but less than 19 cents | 39,500 | 39,500 | |
| 20 cents | 20,000 | | 89,500 |
| 25 cents | 5,500 | 5,500 | |
| 30 cents | 80,500 | | |
| 35 cents | 9,000 | 9,000 | |

[1] Some of the totals shown differ from those obtained by a simple addition of the January–June and July–December data because about 103,500 workers are scheduled to receive wage increases in both halves of the year, and these increases are not necessarily for the same amount for both periods. For example, out of the 165,000 workers scheduled to receive scale increases of 9 but less than 11 cents in the 1st half of the year, 80,500 will also receive a 20-cent increase during the 2d half of the year, a total of 30 cents for the year.

NOTE.—Because of rounding, sums of individual items may not equal totals.

TABLE 10.—*Deferred wage increases due in 1959 in major contracts in manufacturing and selected nonmanufacturing industries by effective month*

| Month | Approximate number of workers affected (in thousands) | Principal industries affected [1] |
|---|---|---|
| Total | [2] 2,472 | |
| January | 378 | Trucking, utilities, coal mining,[3] and various metalworking. |
| February | 211 | Trucking. |
| March | 60 | None. |
| April | 255 | Coal mining.[3] |
| May | 263 | Aircraft. |
| June | 139 | Retail trade and aircraft. |
| July | 60 | Various metalworking. |
| August | 721 | Automobile and related industries. |
| September | 275 | Electrical products and farm equipment. |
| October | 204 | Electrical products, footwear, and flat glass. |
| November | 54 | None. |
| December | [4] 3 | Do. |
| Month not known | 65 | |

[1] See footnote 2, table 8.
[2] The total is smaller than the sum of the individual months since 218,000 employees will receive 2 deferred increases in 1959.
[3] The 2-step wage increase provided for 1959 by the bituminous coal agreement concluded early in December 1958 is not strictly comparable to most of the other agreements summarized here, since both steps go into effect within a year, whereas the other agreements typically specify wage increases for a longer period. The increases consisting of $1.20 a day (15 cents an hour) effective in January 1959 and an additional 80 cents a day (10 cents an hour effective in April) are included since they are part of the 1959 wage picture.
[4] Based on settlements concluded prior to December 1958. Presumably some settlements concluded in that month would provide deferred increases due in December 1959.

NOTE.—Because of rounding, sum of individual items does not necessarily equal total.

TABLE 11.—*Cost-of-living escalator provisions in major contracts in manufacturing and selected nonmanufacturing*[1] *industries providing deferred increases in 1959*

| Item | Approximate number of workers due deferred increases (in thousands) | Percentage of workers covered by cost-of-living escalator clauses |
|---|---|---|
| All situations with deferred increases | 2,472 | 64 |
| AVERAGE DEFERRED WAGE INCREASE | | |
| Under 5 cents | 129 | 34 |
| 5 cents but less than 6 cents | 412 | 87 |
| 6 cents but less than 7 cents | 819 | 87 |
| 7 cents but less than 8 cents | 583 | 69 |
| 8 cents but less than 9 cents | 61 | 28 |
| 9 cents but less than 10 cents | 10 | 20 |
| 10 cents but less than 11 cents | 157 | 14 |
| 11 cents but less than 12 cents | 25 | ---------------- |
| 12 cents but less than 13 cents | 25 | ---------------- |
| 13 cents and over | 222 | 4 |
| Amount not specified or not computed [2] | 27 | 71 |
| INDUSTRY GROUP (SELECTED) | | |
| Manufacturing [3] | 1,680 | 75 |
| Food and kindred products | 65 | 3 |
| Printing and publishing | 28 | 25 |
| Chemicals and allied products | 19 | 10 |
| Stone, clay, and glass products | 40 | 4 |
| Metalworking [4] | 1,450 | 85 |
| Nonmanufacturing | 792 | 42 |
| Mining | 181 | ---------------- |
| Warehousing, wholesale, and retail trade | 136 | 22 |
| Transportation | 423 | 69 |
| Public utilities | 52 | ---------------- |

[1] Excludes certain industries, notably construction, the service trades, finance, and Government.
[2] Insufficient information to compute cents-per-hour increases.
[3] See footnote 3, table 8.
[4] See footnote 4, table 8.

TABLE 12.—*Consumer Price Index—U.S. city average percent change in special groups for selected periods*

| Group | Relative importance December 1957 | Percent change December to December | | | | | Percent change from year 1939 to December 1958 |
|---|---|---|---|---|---|---|---|
| | | 1953-54 | 1954-55 | 1955-56 | 1956-57 | 1957-58 | |
| All items | 100.0 | −0.5 | 0.3 | 2.9 | 3.1 | 1.7 | 108.2 |
| All items less food | 71.4 | 0 | .9 | 2.7 | 3.1 | 1.6 | 83.1 |
| All items less shelter | 81.8 | −1.1 | .2 | 2.9 | 3.0 | 1.9 | 119.3 |
| Commodities | 65.0 | −1.7 | −.4 | 2.9 | 2.6 | 1.4 | 125.4 |
| Nondurables | 51.4 | −1.3 | .1 | 2.9 | 2.6 | 1.2 | 129.2 |
| Food | 28.6 | −1.7 | −.8 | 3.1 | 2.8 | 2.2 | 152.0 |
| Nondurables less food | 22.8 | −.6 | 1.1 | 2.8 | 2.3 | −.3 | 99.3 |
| Apparel | 8.8 | −.9 | .3 | 2.3 | .4 | −.1 | 106.3 |
| Nondurables less food and apparel | 14.0 | −.5 | 1.6 | 3.1 | 3.5 | −.3 | 90.3 |
| Durables | 13.6 | −3.5 | −1.8 | 2.8 | 2.1 | 2.4 | 97.0 |
| New cars | 3.0 | 1.4 | −2.4 | 7.8 | 2.0 | 6.2 | 151.9 |
| Used cars (January 1953=100) | 1.6 | −11.1 | −6.6 | 6.3 | 8.1 | 8.9 | (1) |
| Durables less cars | 9.0 | −3.7 | −1.7 | 1.1 | 1.3 | 0 | 80.1 |
| Commodities less food | 36.4 | −1.7 | 0 | 2.8 | 2.3 | .7 | 92.6 |
| Services | 34.2 | 1.8 | 1.9 | 2.7 | 4.2 | 2.5 | 78.5 |
| Rent | 5.8 | 1.4 | 1.3 | 2.4 | 1.9 | 1.5 | 60.2 |
| Services less rent | 28.4 | 1.9 | 2.0 | 2.7 | 4.6 | 2.8 | 97.3 |
| Household operation services gas, and electricity | 6.7 | .1 | 3.3 | 2.4 | 3.2 | 2.9 | 52.9 |
| Transportation | 4.0 | 2.6 | −.5 | 2.8 | 6.2 | 5.1 | 120.0 |
| Medical care | 4.4 | 2.6 | 3.2 | 4.0 | 4.5 | 5.1 | 116.2 |
| Other services [2] | 13.3 | 2.3 | 1.7 | 2.4 | 4.9 | 1.2 | 122.6 |
| Purchasing power of the consumer dollar (1947-49=$1) | | .6 | −.3 | −2.9 | −3.0 | −1.7 | −52.0 |

[1] Not available.

[2] Includes house purchase, interest, taxes, insurance and upkeep services; shoe repairs television repairs barber and beauty shop services and movies.

CHART 1

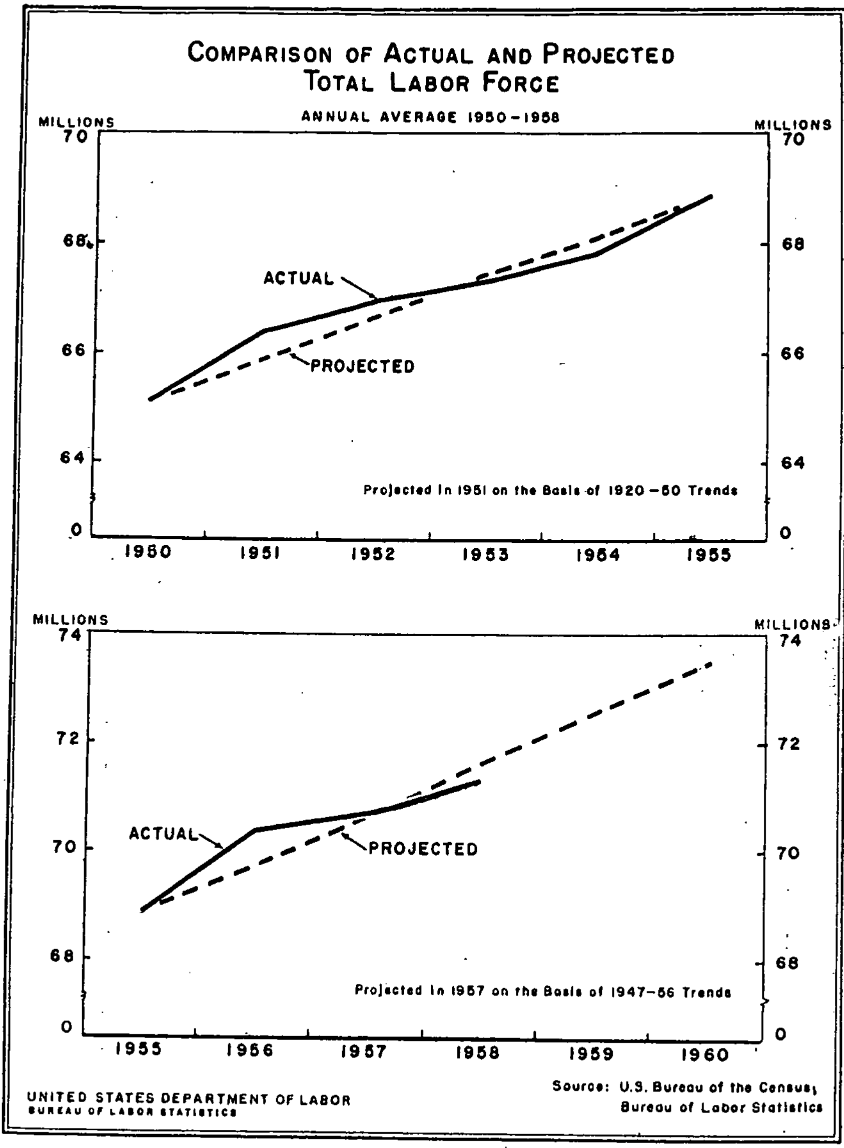

COMPARISON OF ACTUAL AND PROJECTED
TOTAL LABOR FORCE
ANNUAL AVERAGE 1950-1958
MILLIONS
70
68
66
64
0
ACTUAL
PROJECTED
Projected in 1951 on the Basis of 1920-50 Trends
1950
1951
1952
1953
1954
1955
MILLIONS
74
72
70
68
0
ACTUAL
PROJECTED
Projected in 1957 on the Basis of 1947-56 Trends
1955
1956
1957
1958
1959
1960
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
Source: U.S. Bureau of the Census;
Bureau of Labor Statistics

CHART 2

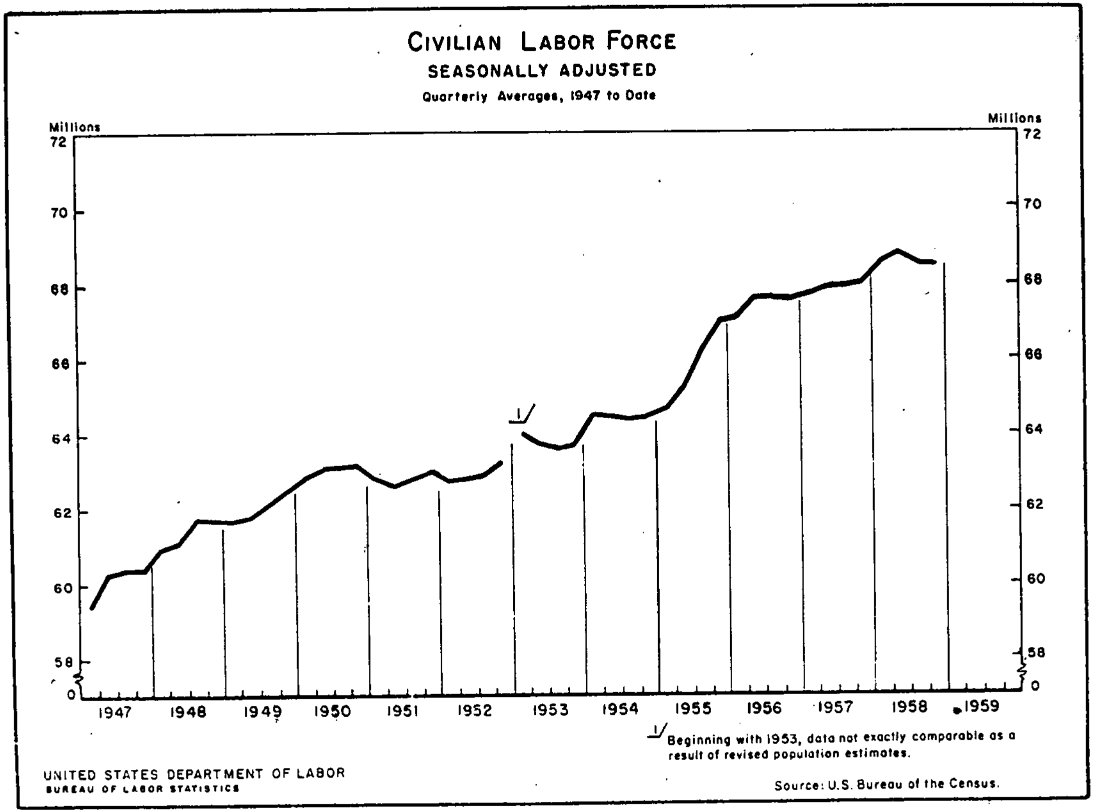

CIVILIAN LABOR FORCE
SEASONALLY ADJUSTED
Quarterly Averages, 1947 to Date
Millions
Millions
72
70
68
66
64
62
60
58
0
1/
1947
1948
1949
1950
1951
1952
1953
1954
1955
1956
1957
1958
1959
1/ Beginning with 1953, data not exactly comparable as a result of revised population estimates.
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
Source: U.S. Bureau of the Census.

CHART 3A

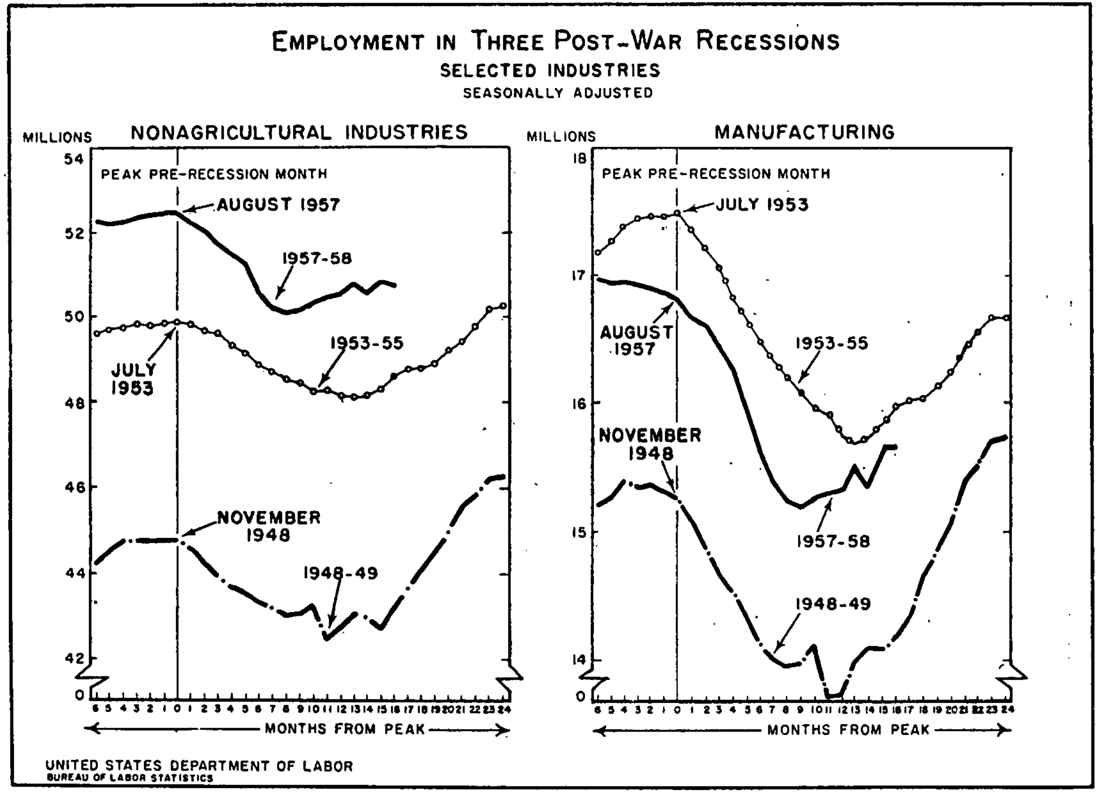

EMPLOYMENT IN THREE POST-WAR RECESSIONS
SELECTED INDUSTRIES
SEASONALLY ADJUSTED
NONAGRICULTURAL INDUSTRIES
MANUFACTURING
MILLIONS
PEAK PRE-RECESSION MONTH
AUGUST 1957
1957-58
JULY 1953
1953-55
NOVEMBER 1948
1948-49
MONTHS FROM PEAK
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

CHART 3B

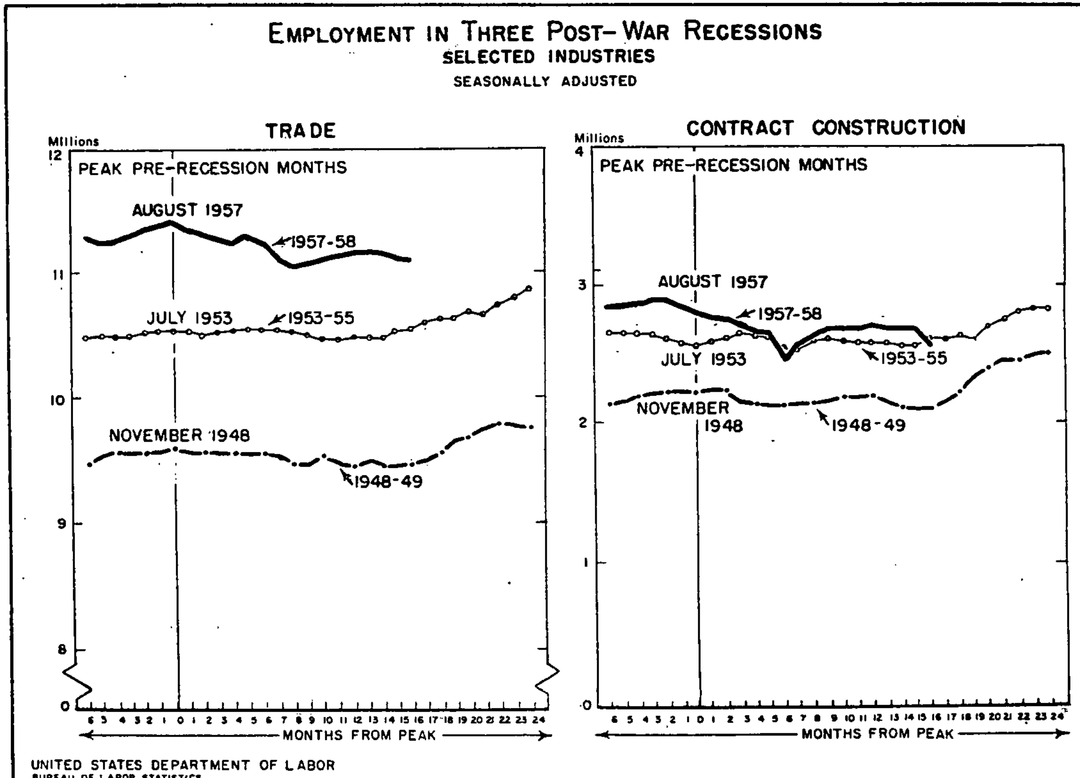

EMPLOYMENT IN THREE POST-WAR RECESSIONS
SELECTED INDUSTRIES
SEASONALLY ADJUSTED
TRADE
Millions
PEAK PRE-RECESSION MONTHS
AUGUST 1957
1957-58
JULY 1953
1953-55
NOVEMBER 1948
1948-49
MONTHS FROM PEAK
CONTRACT CONSTRUCTION
Millions
PEAK PRE-RECESSION MONTHS
AUGUST 1957
1957-58
JULY 1953
1953-55
NOVEMBER 1948
1948-49
MONTHS FROM PEAK
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

CHART 3C

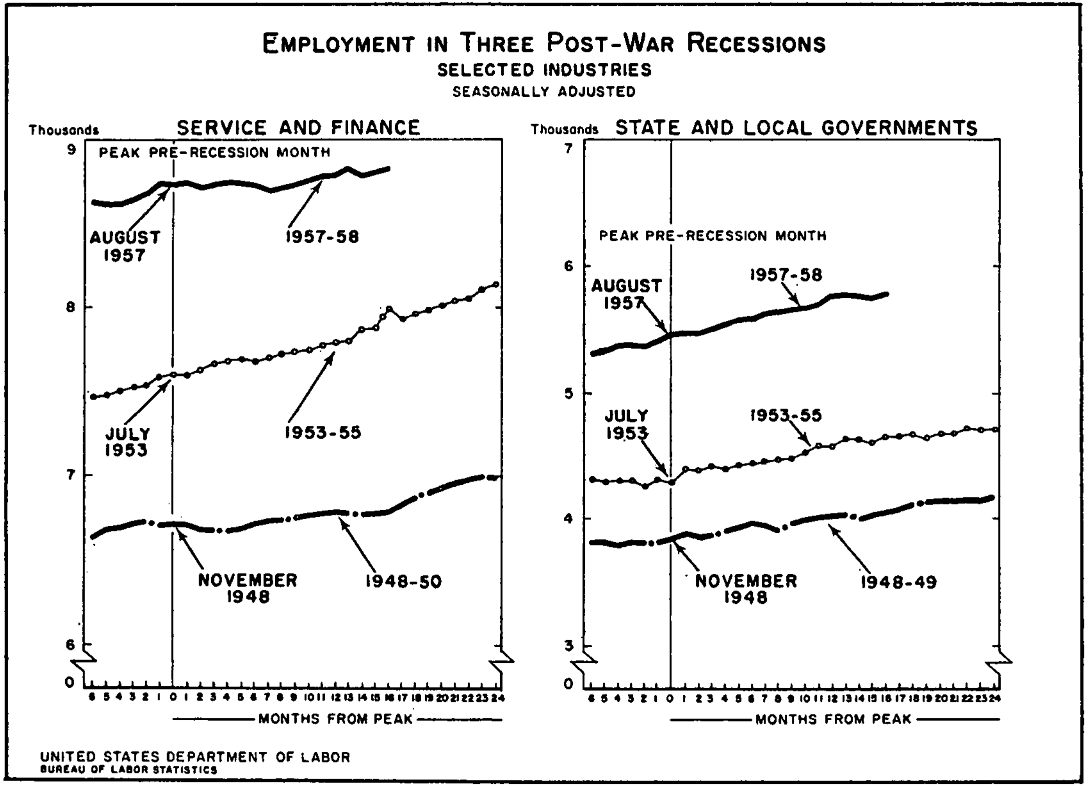

EMPLOYMENT IN THREE POST-WAR RECESSIONS
SELECTED INDUSTRIES
SEASONALLY ADJUSTED
Thousands
SERVICE AND FINANCE
PEAK PRE-RECESSION MONTH
AUGUST 1957
1957-58
JULY 1953
1953-55
NOVEMBER 1948
1948-50
MONTHS FROM PEAK
Thousands
STATE AND LOCAL GOVERNMENTS
PEAK PRE-RECESSION MONTH
AUGUST 1957
1957-58
JULY 1953
1953-55
NOVEMBER 1948
1948-49
MONTHS FROM PEAK
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

CHART 4

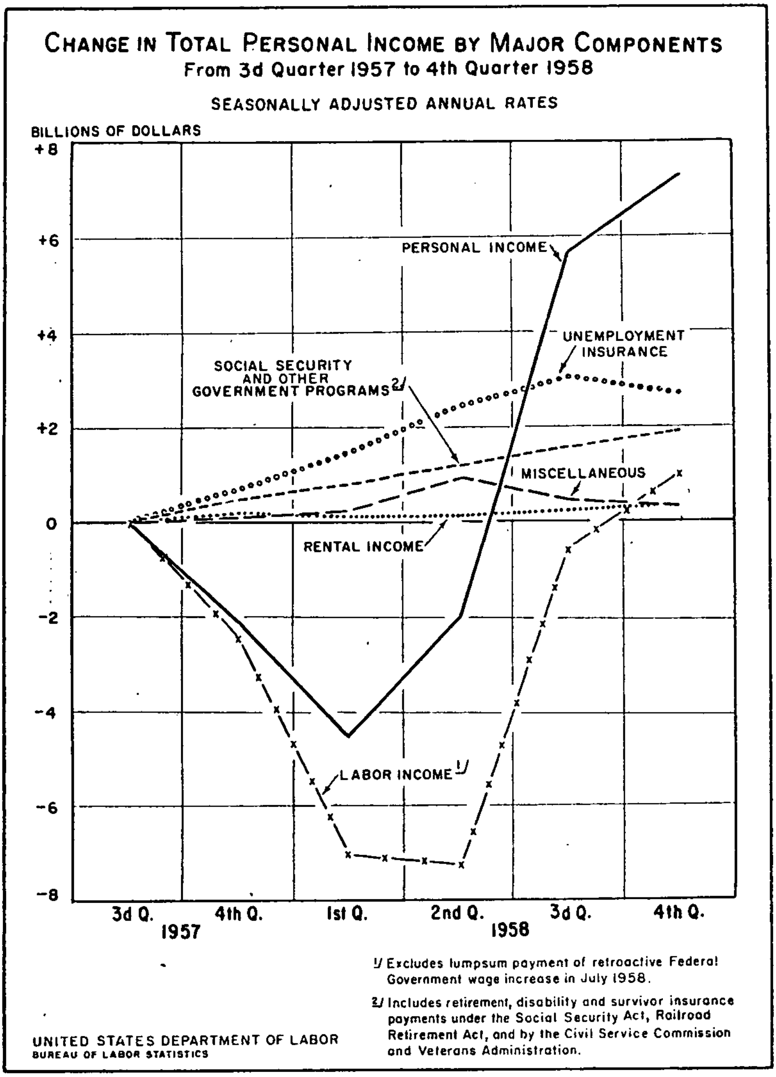
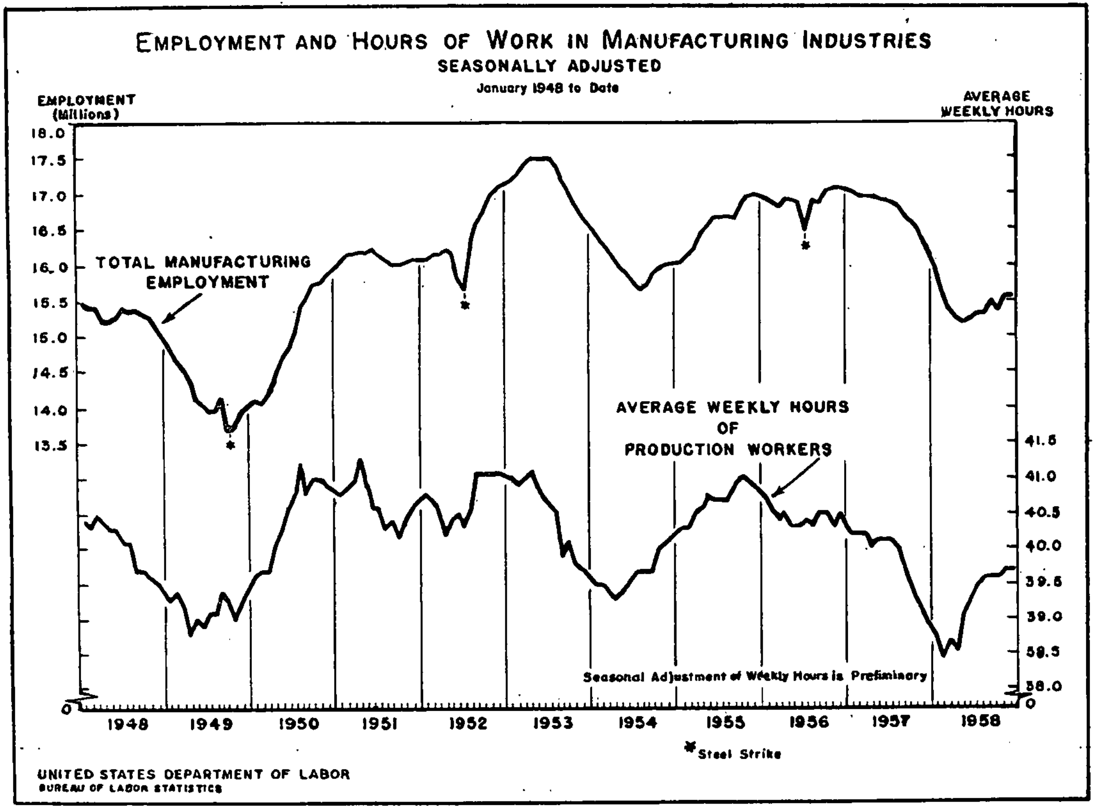

CHANGE IN TOTAL PERSONAL INCOME BY MAJOR COMPONENTS
From 3d Quarter 1957 to 4th Quarter 1958
SEASONALLY ADJUSTED ANNUAL RATES
BILLIONS OF DOLLARS
+8
+6
+4
+2
0
-2
-4
-6
-8
PERSONAL INCOME
UNEMPLOYMENT INSURANCE
SOCIAL SECURITY AND OTHER GOVERNMENT PROGRAMS 2/
MISCELLANEOUS
RENTAL INCOME
LABOR INCOME 1/
3d Q.
4th Q.
1957
1st Q.
2nd Q.
3d Q.
4th Q.
1958
1/ Excludes lumpsum payment of retroactive Federal Government wage increase in July 1958.
2/ Includes retirement, disability and survivor insurance payments under the Social Security Act, Railroad Retirement Act, and by the Civil Service Commission and Veterans Administration.
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

Chart 5



EMPLOYMENT AND HOURS OF WORK IN MANUFACTURING INDUSTRIES
SEASONALLY ADJUSTED
January 1948 to Date
EMPLOYMENT (Millions)
AVERAGE WEEKLY HOURS
18.0
17.5
17.0
16.5
16.0
15.5
15.0
14.5
14.0
13.5
0
TOTAL MANUFACTURING EMPLOYMENT
AVERAGE WEEKLY HOURS OF PRODUCTION WORKERS
41.5
41.0
40.5
40.0
39.5
39.0
38.5
38.0
0
Seasonal Adjustment of Weekly Hours is Preliminary
1948
1949
1950
1951
1952
1953
1954
1955
1956
1957
1958
*Steel Strike
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

CHART 6

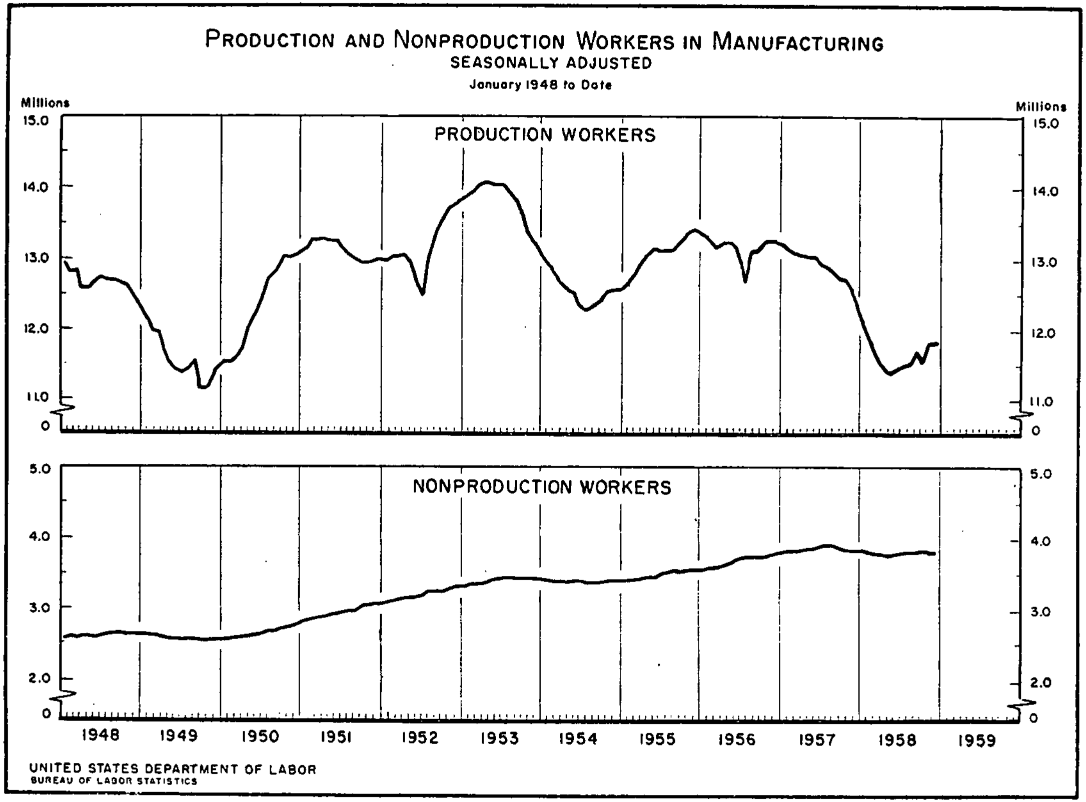

PRODUCTION AND NONPRODUCTION WORKERS IN MANUFACTURING
SEASONALLY ADJUSTED
January 1948 to Date
Millions
PRODUCTION WORKERS
NONPRODUCTION WORKERS
15.0
14.0
13.0
12.0
11.0
0
5.0
4.0
3.0
2.0
1948
1949
1950
1951
1952
1953
1954
1955
1956
1957
1958
1959
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

CHART 7

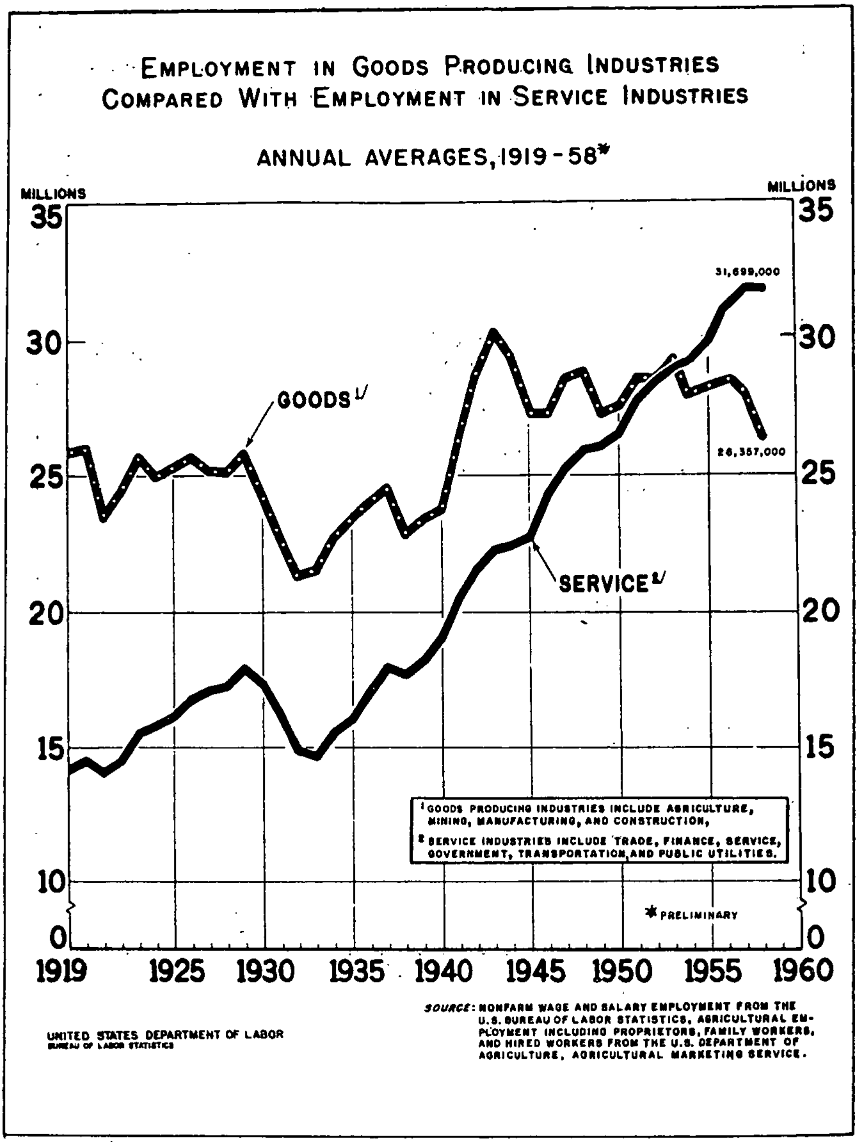

EMPLOYMENT IN GOODS PRODUCING INDUSTRIES
COMPARED WITH EMPLOYMENT IN SERVICE INDUSTRIES
ANNUAL AVERAGES, 1919-58*
MILLIONS
MILLIONS
35
30
25
20
15
10
0
31,699,000
26,357,000
GOODS 1/
SERVICE 2/
1 GOODS PRODUCING INDUSTRIES INCLUDE AGRICULTURE, MINING, MANUFACTURING, AND CONSTRUCTION,
2 SERVICE INDUSTRIES INCLUDE TRADE, FINANCE, SERVICE, GOVERNMENT, TRANSPORTATION, AND PUBLIC UTILITIES.
* PRELIMINARY
1919
1925
1930
1935
1940
1945
1950
1955
1960
SOURCE: NONFARM WAGE AND SALARY EMPLOYMENT FROM THE U.S. BUREAU OF LABOR STATISTICS, AGRICULTURAL EMPLOYMENT INCLUDING PROPRIETORS, FAMILY WORKERS, AND HIRED WORKERS FROM THE U.S. DEPARTMENT OF AGRICULTURE, AGRICULTURAL MARKETING SERVICE.
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

CHART 8

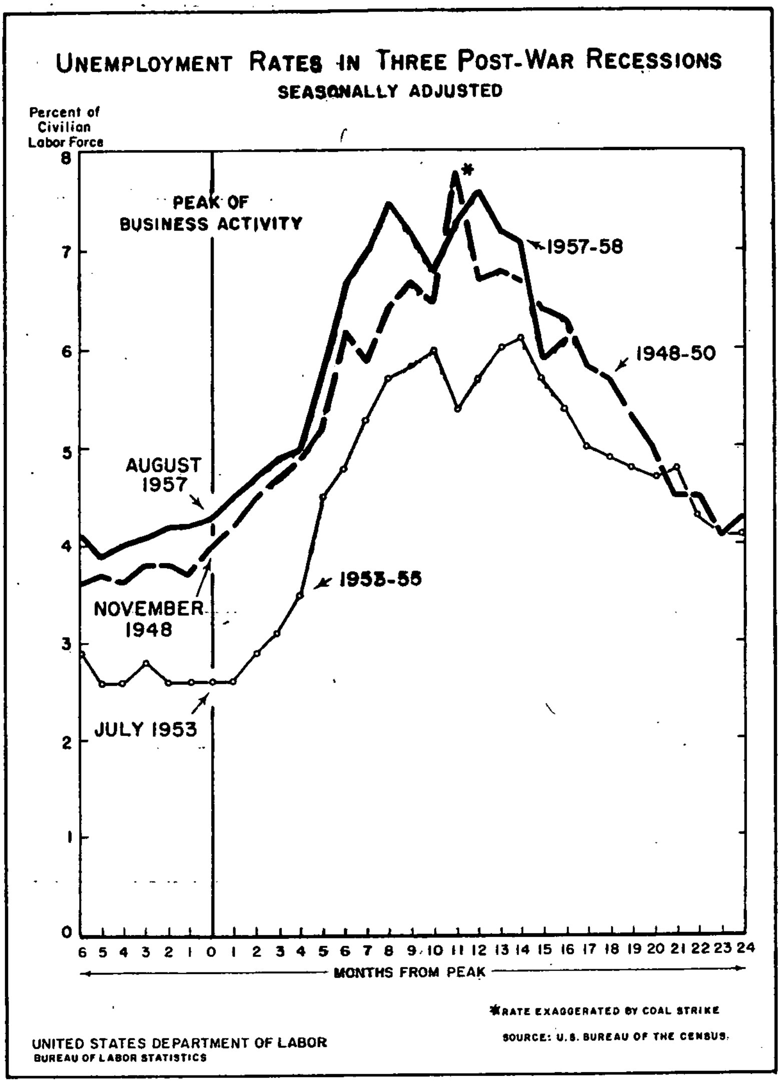

UNEMPLOYMENT RATES IN THREE POST-WAR RECESSIONS
SEASONALLY ADJUSTED
Percent of Civilian Labor Force
PEAK OF BUSINESS ACTIVITY
1957-58
1948-50
1953-55
AUGUST 1957
NOVEMBER 1948
JULY 1953
0
1
2
3
4
5
6
7
8
6 5 4 3 2 1 0 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24
MONTHS FROM PEAK
*RATE EXAGGERATED BY COAL STRIKE
SOURCE: U.S. BUREAU OF THE CENSUS.
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

CHART 9

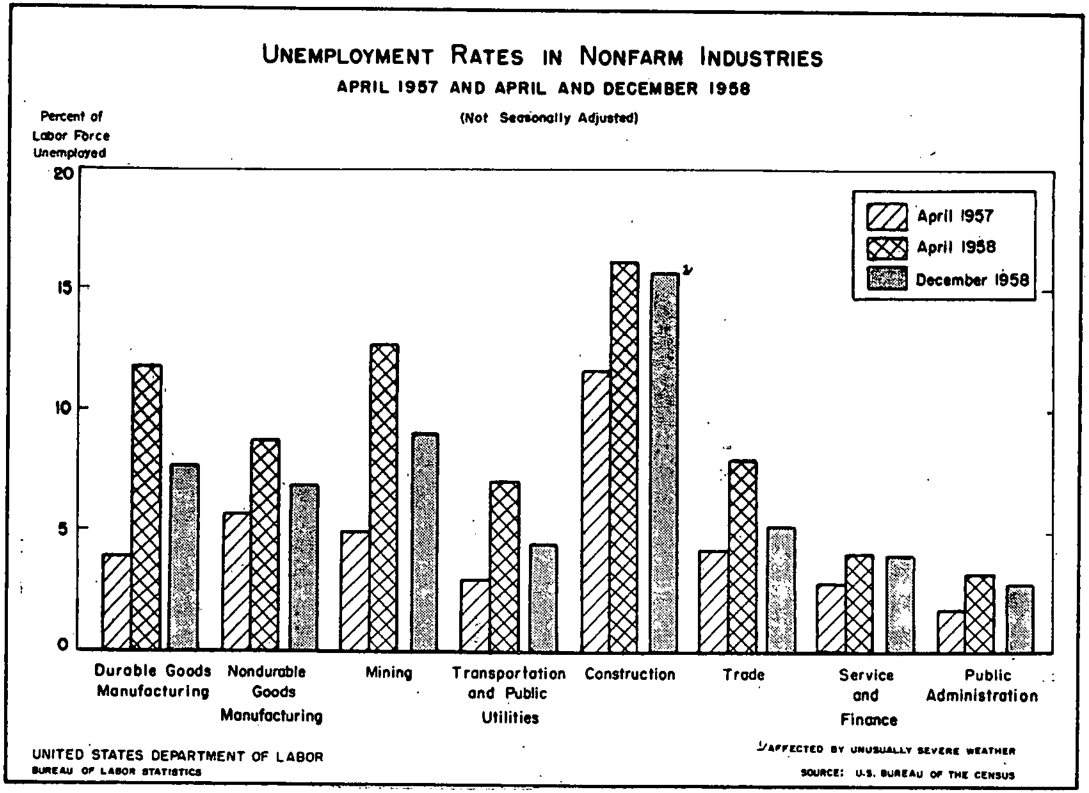

UNEMPLOYMENT RATES IN NONFARM INDUSTRIES
APRIL 1957 AND APRIL AND DECEMBER 1958
(Not Seasonally Adjusted)
Percent of Labor Force Unemployed
20
15
10
5
0
April 1957
April 1958
December 1958
Durable Goods Manufacturing
Nondurable Goods Manufacturing
Mining
Transportation and Public Utilities
Construction
Trade
Service and Finance
Public Administration
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
1/ AFFECTED BY UNUSUALLY SEVERE WEATHER
SOURCE: U.S. BUREAU OF THE CENSUS

CHART 10

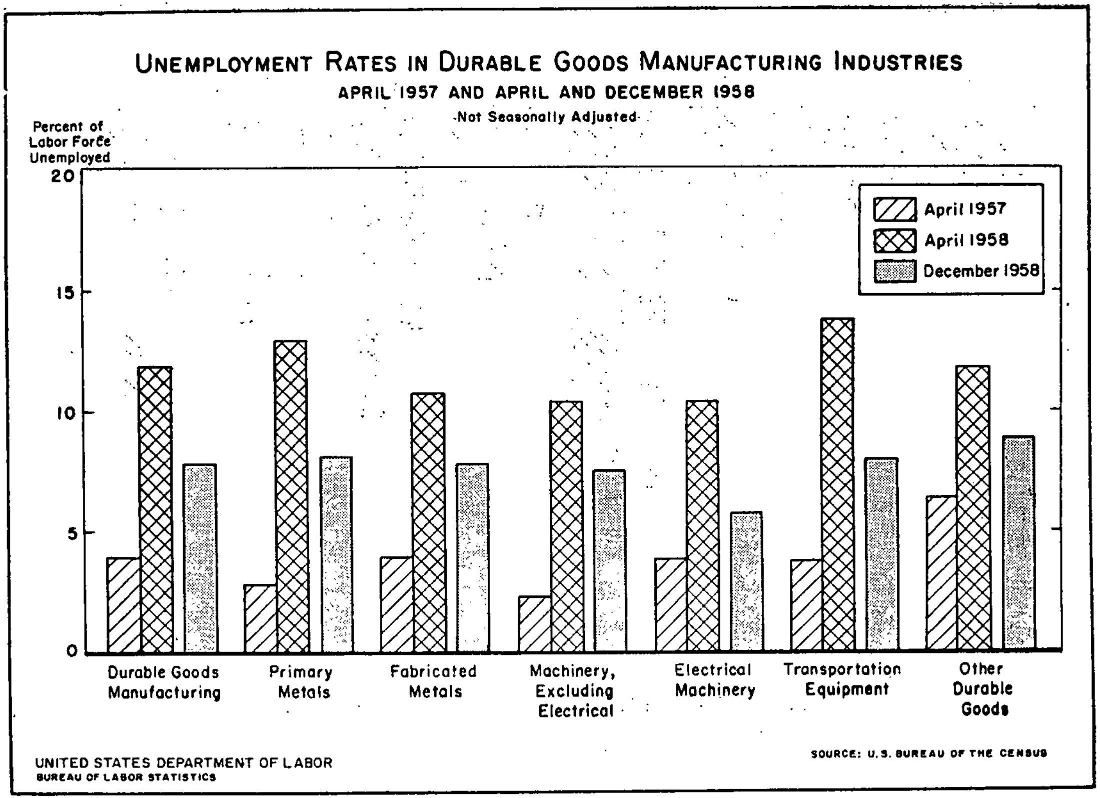

UNEMPLOYMENT RATES IN DURABLE GOODS MANUFACTURING INDUSTRIES
APRIL 1957 AND APRIL AND DECEMBER 1958
Not Seasonally Adjusted
Percent of Labor Force Unemployed
20
15
10
5
0
April 1957
April 1958
December 1958
Durable Goods Manufacturing
Primary Metals
Fabricated Metals
Machinery, Excluding Electrical
Electrical Machinery
Transportation Equipment
Other Durable Goods
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
SOURCE: U.S. BUREAU OF THE CENSUS

CHART 11

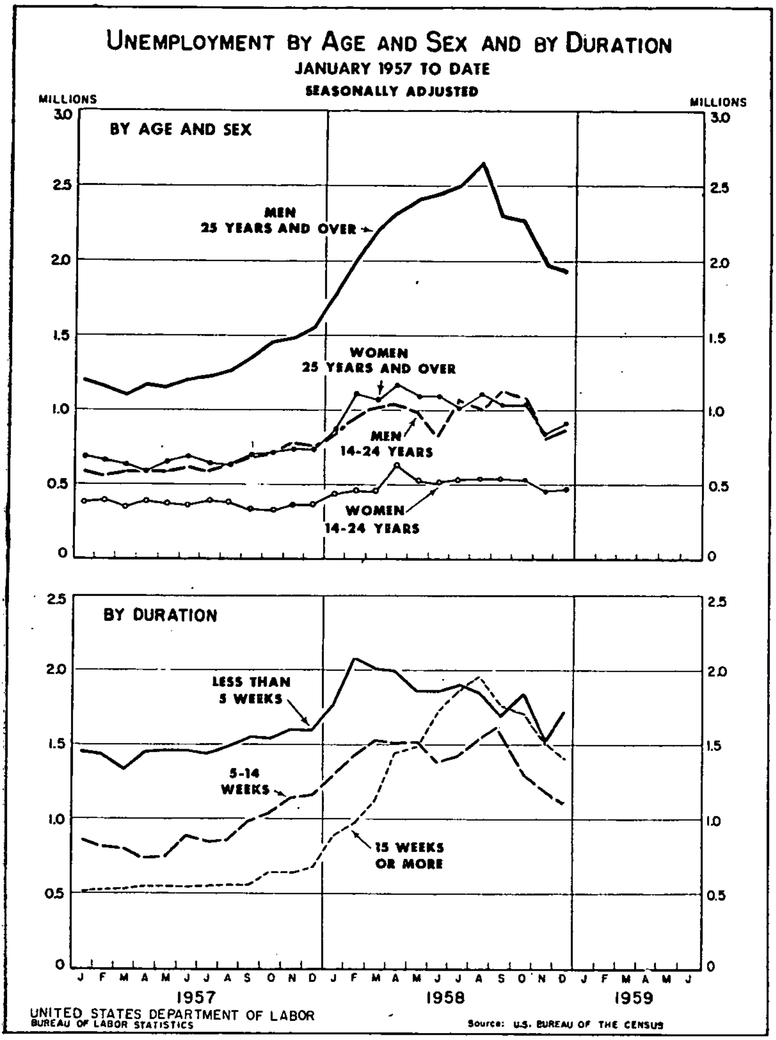

UNEMPLOYMENT BY AGE AND SEX AND BY DURATION
JANUARY 1957 TO DATE
SEASONALLY ADJUSTED
MILLIONS
BY AGE AND SEX
MEN 25 YEARS AND OVER
WOMEN 25 YEARS AND OVER
MEN 14-24 YEARS
WOMEN 14-24 YEARS
BY DURATION
LESS THAN 5 WEEKS
5-14 WEEKS
15 WEEKS OR MORE
J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J
1957
1958
1959
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
Source: U.S. BUREAU OF THE CENSUS

**Chart 12**

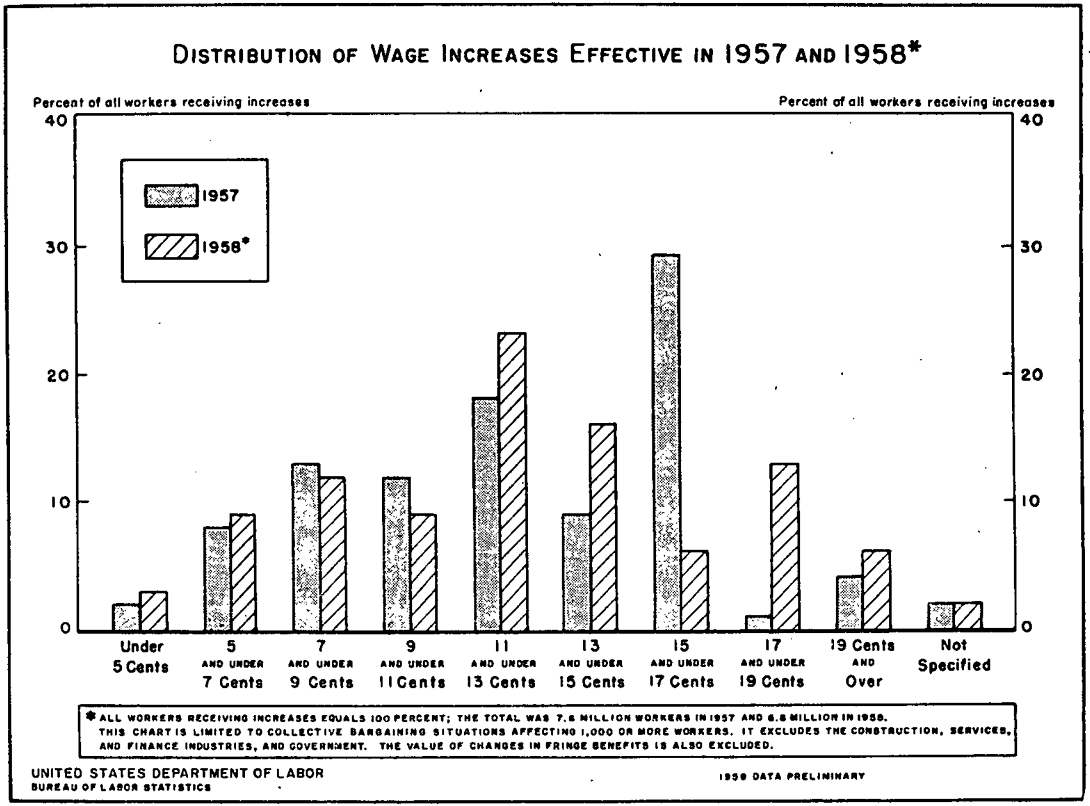
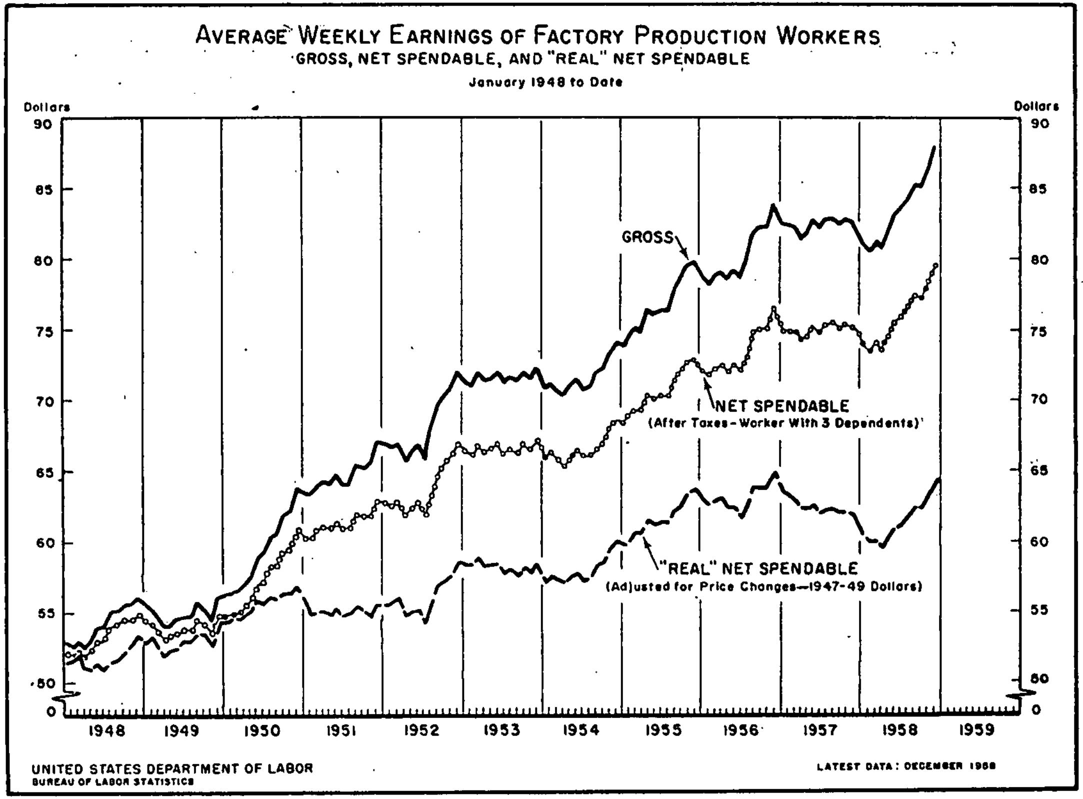

DISTRIBUTION OF WAGE INCREASES EFFECTIVE IN 1957 AND 1958*
Percent of all workers receiving increases
Percent of all workers receiving increases
40
30
20
10
0
1957
1958*
Under 5 Cents
5 AND UNDER 7 Cents
7 AND UNDER 9 Cents
9 AND UNDER 11 Cents
11 AND UNDER 13 Cents
13 AND UNDER 15 Cents
15 AND UNDER 17 Cents
17 AND UNDER 19 Cents
19 Cents AND Over
Not Specified
* ALL WORKERS RECEIVING INCREASES EQUALS 100 PERCENT; THE TOTAL WAS 7.6 MILLION WORKERS IN 1957 AND 6.8 MILLION IN 1958.
THIS CHART IS LIMITED TO COLLECTIVE BARGAINING SITUATIONS AFFECTING 1,000 OR MORE WORKERS. IT EXCLUDES THE CONSTRUCTION, SERVICES, AND FINANCE INDUSTRIES, AND GOVERNMENT. THE VALUE OF CHANGES IN FRINGE BENEFITS IS ALSO EXCLUDED.
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
1958 DATA PRELIMINARY

CHART 13



AVERAGE WEEKLY EARNINGS OF FACTORY PRODUCTION WORKERS
GROSS, NET SPENDABLE, AND "REAL" NET SPENDABLE
January 1948 to Date
Dollars
Dollars
90
85
80
75
70
65
60
55
50
0
GROSS
NET SPENDABLE
(After Taxes-Worker With 3 Dependents)
"REAL" NET SPENDABLE
(Adjusted for Price Changes—1947-49 Dollars)
1948
1949
1950
1951
1952
1953
1954
1955
1956
1957
1958
1959
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
LATEST DATA: DECEMBER 1958

CHART 14

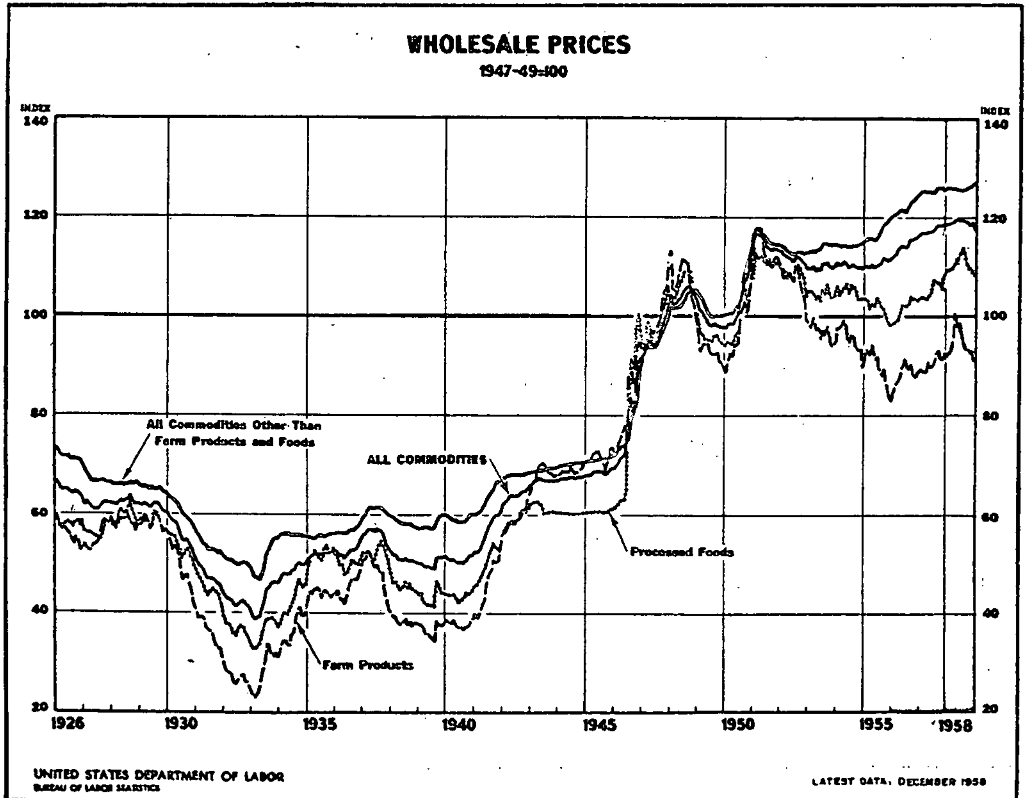

WHOLESALE PRICES
1947-49=100
INDEX
140
120
100
80
60
40
20
1926
1930
1935
1940
1945
1950
1955
1958
All Commodities Other Than Farm Products and Foods
ALL COMMODITIES
Processed Foods
Farm Products
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
LATEST DATA, DECEMBER 1958

CHART 15

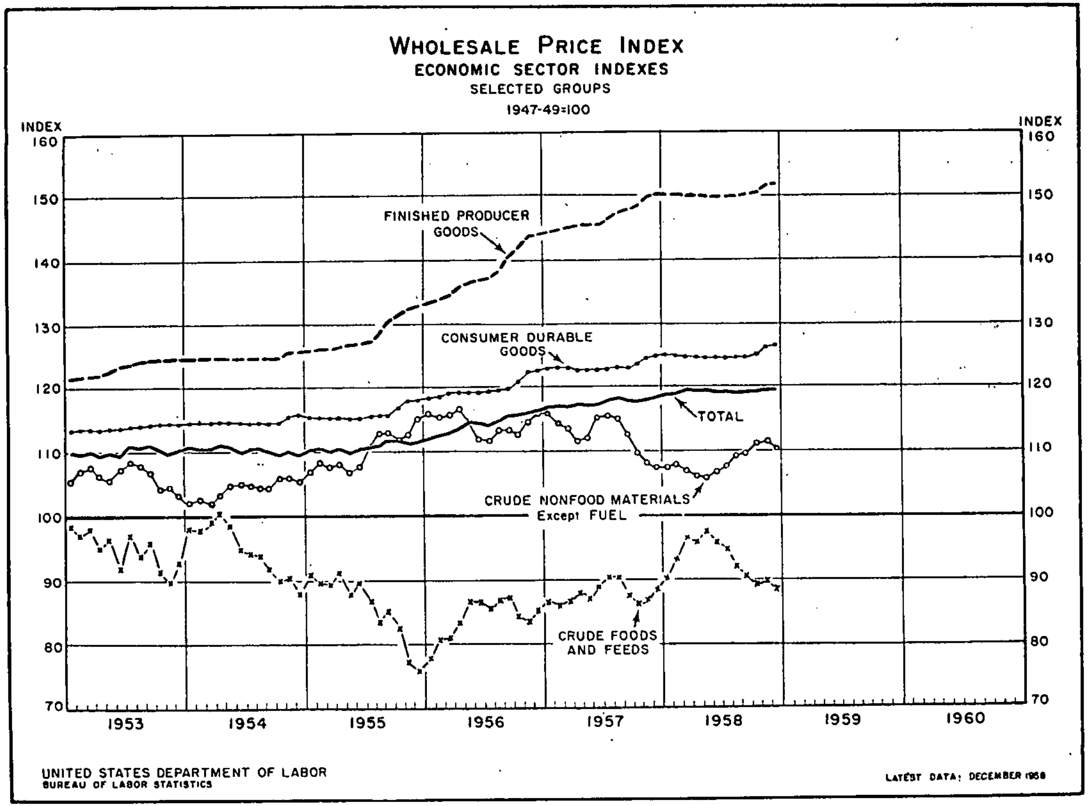

WHOLESALE PRICE INDEX
ECONOMIC SECTOR INDEXES
SELECTED GROUPS
1947-49=100
INDEX
160
150
140
130
120
110
100
90
80
70
FINISHED PRODUCER GOODS
CONSUMER DURABLE GOODS
TOTAL
CRUDE NONFOOD MATERIALS Except FUEL
CRUDE FOODS AND FEEDS
1953
1954
1955
1956
1957
1958
1959
1960
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
LATEST DATA: DECEMBER 1958

CHART 16

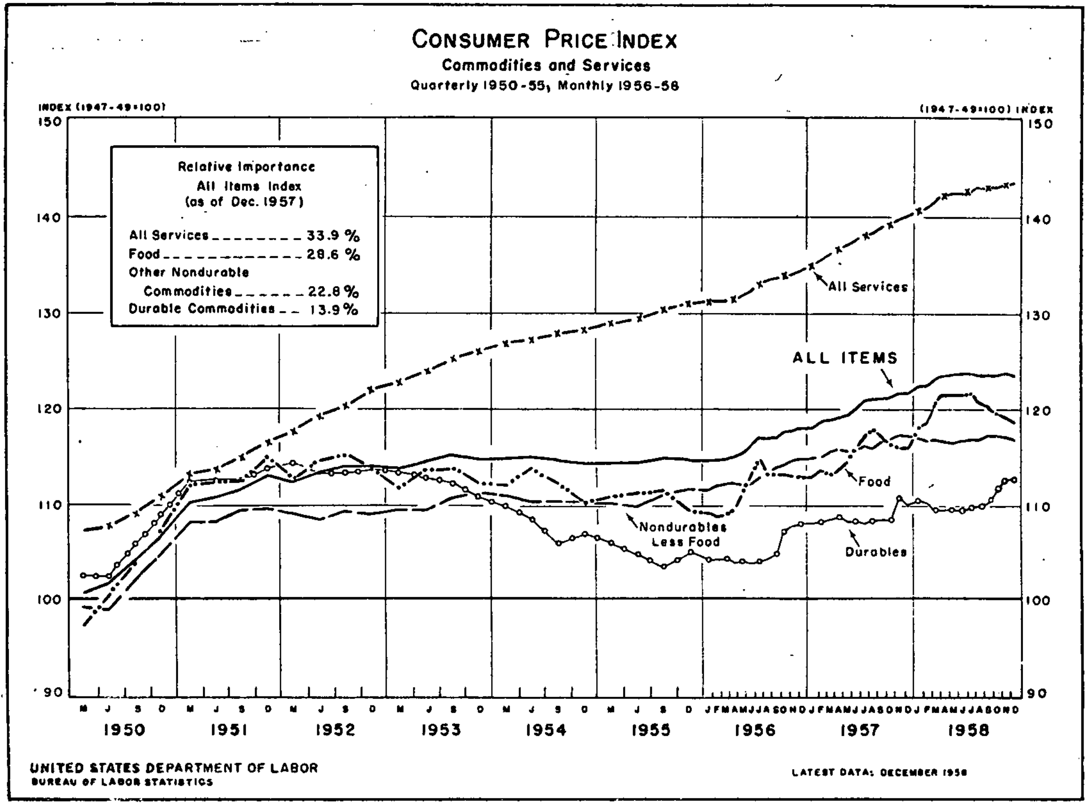
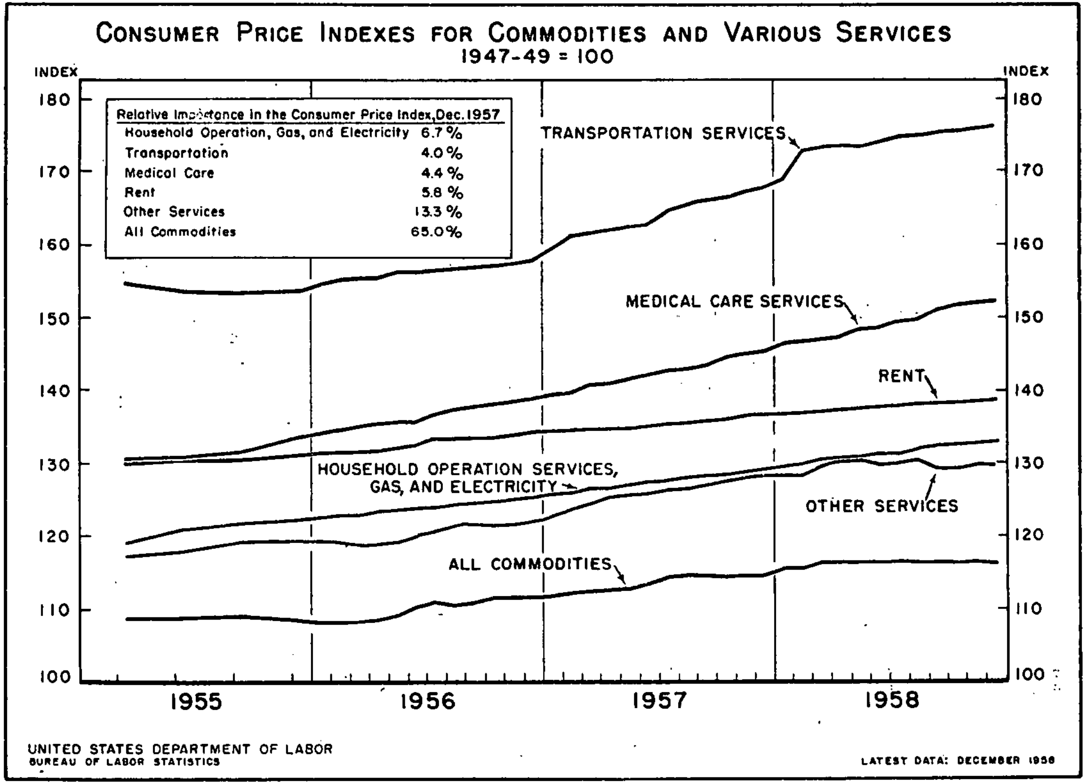

CONSUMER PRICE INDEX
Commodities and Services
Quarterly 1950-55, Monthly 1956-58
INDEX (1947-49=100)
(1947-49=100) INDEX
Relative Importance
All Items Index
(as of Dec. 1957)
All Services ........ 33.9 %
Food ........ 28.6 %
Other Nondurable
Commodities ........ 22.8 %
Durable Commodities .. 13.9 %
All Services
ALL ITEMS
Food
Nondurables
Less Food
Durables
150
140
130
120
110
100
90
1950
1951
1952
1953
1954
1955
1956
1957
1958
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
LATEST DATA: DECEMBER 1958

CHART 17



CONSUMER PRICE INDEXES FOR COMMODITIES AND VARIOUS SERVICES
1947-49 = 100
INDEX
INDEX
180
170
160
150
140
130
120
110
100
Relative Importance in the Consumer Price Index, Dec. 1957
Household Operation, Gas, and Electricity 6.7 %
Transportation 4.0 %
Medical Care 4.4 %
Rent 5.8 %
Other Services 13.3 %
All Commodities 65.0 %
TRANSPORTATION SERVICES
MEDICAL CARE SERVICES
RENT
HOUSEHOLD OPERATION SERVICES, GAS, AND ELECTRICITY
OTHER SERVICES
ALL COMMODITIES
1955
1956
1957
1958
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
LATEST DATA: DECEMBER 1958

CHART 18

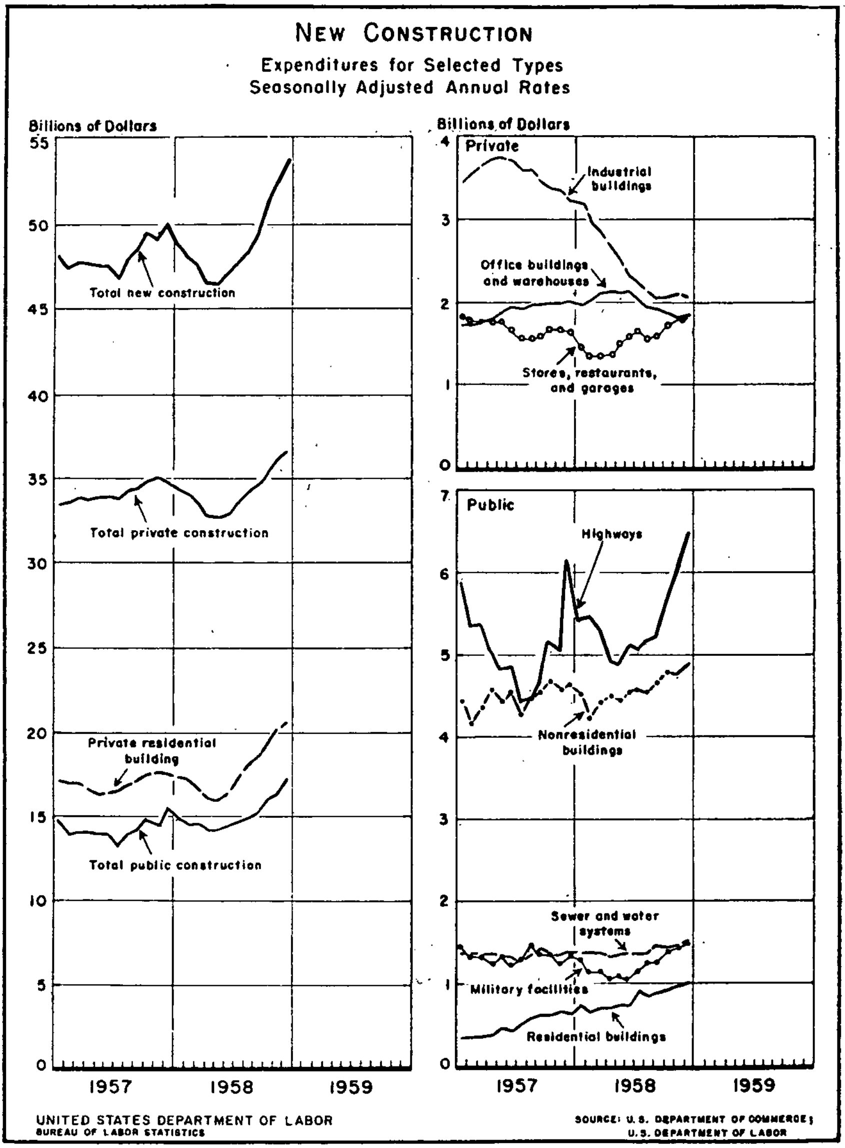

NEW CONSTRUCTION
Expenditures for Selected Types
Seasonally Adjusted Annual Rates
Billions of Dollars
55
50
45
40
35
30
25
20
15
10
5
0
Total new construction
Total private construction
Private residential building
Total public construction
Billions of Dollars
4
3
2
1
0
Private
Industrial buildings
Office buildings and warehouses
Stores, restaurants, and garages
7
6
5
4
3
2
1
0
Public
Highways
Nonresidential buildings
Sewer and water systems
Military facilities
Residential buildings
1957
1958
1959
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
SOURCE: U. S. DEPARTMENT OF COMMERCE; U. S. DEPARTMENT OF LABOR

CHART 19

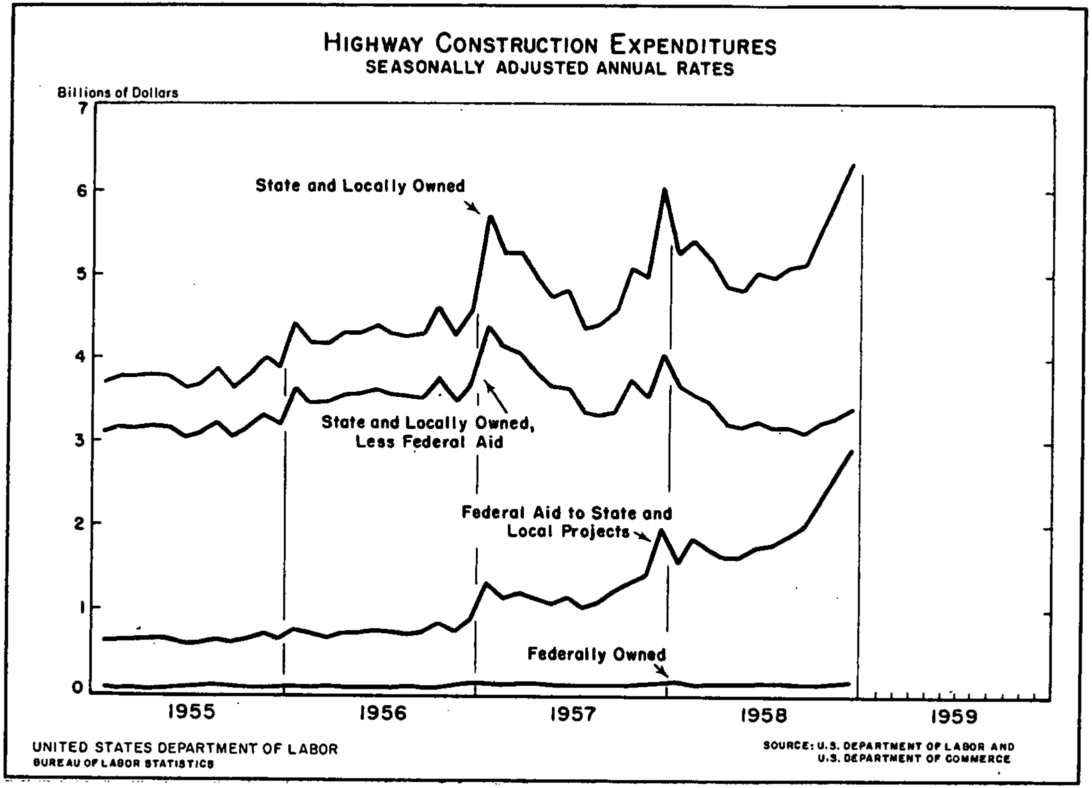
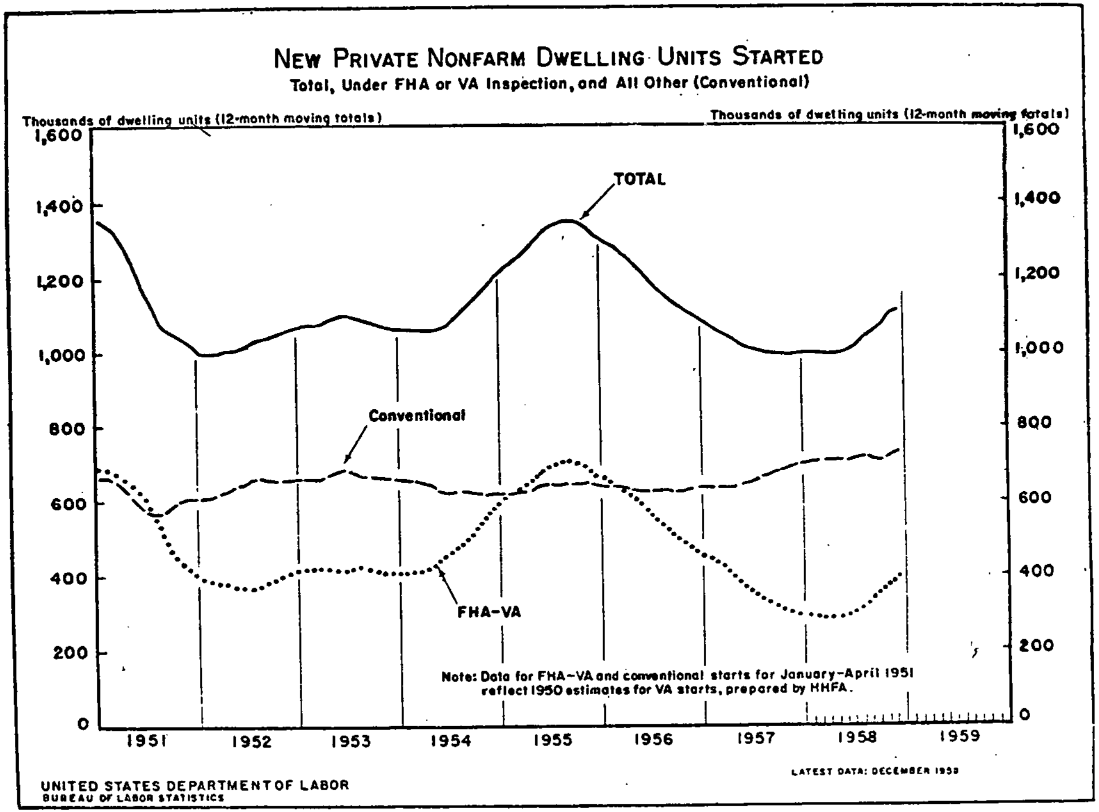
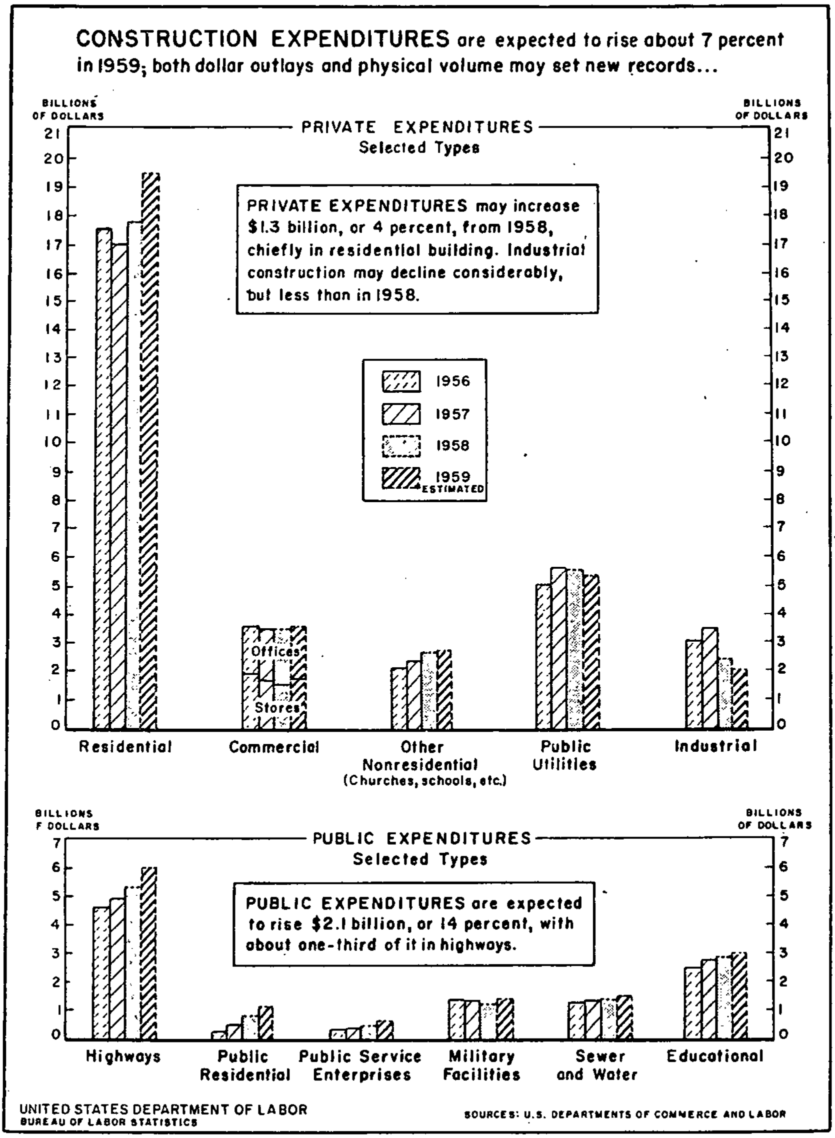

HIGHWAY CONSTRUCTION EXPENDITURES
SEASONALLY ADJUSTED ANNUAL RATES
Billions of Dollars
7
6
5
4
3
2
1
0
State and Locally Owned
State and Locally Owned, Less Federal Aid
Federal Aid to State and Local Projects
Federally Owned
1955
1956
1957
1958
1959
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
SOURCE: U.S. DEPARTMENT OF LABOR AND U.S. DEPARTMENT OF COMMERCE

CHART 20



NEW PRIVATE NONFARM DWELLING UNITS STARTED
Total, Under FHA or VA Inspection, and All Other (Conventional)
Thousands of dwelling units (12-month moving totals)
Thousands of dwelling units (12-month moving totals)
1,600
1,400
1,200
1,000
800
600
400
200
0
TOTAL
Conventional
FHA-VA
Note: Data for FHA-VA and conventional starts for January-April 1951 reflect 1950 estimates for VA starts, prepared by HHFA.
1951
1952
1953
1954
1955
1956
1957
1958
1959
LATEST DATA: DECEMBER 1958
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

CHART 21


CONSTRUCTION EXPENDITURES are expected to rise about 7 percent in 1959; both dollar outlays and physical volume may set new records...
BILLIONS OF DOLLARS
PRIVATE EXPENDITURES
Selected Types
PRIVATE EXPENDITURES may increase $1.3 billion, or 4 percent, from 1958, chiefly in residential building. Industrial construction may decline considerably, but less than in 1958.
1956
1957
1958
1959 ESTIMATED
Offices
Stores
Residential
Commercial
Other Nonresidential (Churches, schools, etc.)
Public Utilities
Industrial
PUBLIC EXPENDITURES
Selected Types
PUBLIC EXPENDITURES are expected to rise $2.1 billion, or 14 percent, with about one-third of it in highways.
Highways
Public Residential
Public Service Enterprises
Military Facilities
Sewer and Water
Educational
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
SOURCES: U.S. DEPARTMENTS OF COMMERCE AND LABOR

Representative PATMAN. The discussion will be continued by Mr. Paradiso, the Assistant Director of the Office of Business Economics. He will discuss Government demand.

Mr. PARADISO. Thank you, Mr. Chairman.

## STATEMENT OF LOUIS J. PARADISO, ASSISTANT DIRECTOR AND CHIEF STATISTICIAN, OFFICE OF BUSINESS ECONOMICS, DEPARTMENT OF COMMERCE

Mr. PARADISO. It is my job today to discuss Government demand as reflected by the January budget translated into the national income and product accounts.

At the present time, purchases of goods and services by Government—Federal, State, and local—comprise more than one-fifth of the gross national product. The Federal portion is 12 percent.

In addition to these purchases, Governments also influence the economy importantly through various other activities. The budget presented by the President about this time last year for the fiscal year 1959 implied an increase in Government purchases over the fiscal 1958 total, and enlarged programs and appropriations were enacted by Congress. The upturn in such purchases, together with other Government programs, contributed importantly to the economic recovery now underway.

We have made a translation of the 1960 budget into the national income and product accounts to evaluate its effect upon national economic activity. Only broad categories were examined, but for the purpose of appraising the overall economic impact, the results obtained provide useful guides.

I shall first discuss the implications of the budget on Government expenditures. Exhibit 1 shows that in the national income framework the budget expenditure estimates imply a total of $92 billion in fiscal 1960, up $1 billion from the estimate for fiscal 1959. In the first half of calendar 1959, total expenditures are estimated at a seasonally adjusted annual rate of approximately $92 billion so that little change is indicated for fiscal 1960 from the current rate. This differs from the decline in expenditures shown from fiscal 1959 to fiscal 1960 in both the administrative and cash budgets.

Exhibit 1 provides for broad categories, a reconciliation of the three budget measures.

The administrative budget expenditures drop by nearly $4 billion from fiscal 1959 to fiscal 1960. The cash budget expenditures, representing all payments to the public, drop by $2 billion. This difference is due mostly to (1) a rise in payments out of trust funds amounting to about $1½ billion, and (2) an expenditure in the administrative budget representing the issuance of International Monetary Fund notes amounting to more than a billion dollars in fiscal 1959. This latter item does not appear in the 1960 budget.

The cash budget does not include such expenditures. It is to be observed that loans and other capital transactions of such agencies as FNMA, Export-Import Bank, Commodity Credit Corporation, and REA.

Finally, adjusting the cash budget to eliminate such loans and other capital transactions, the rise in estimated Federal expenditures from 1959 on an income and product account basis is $1 billion.

Let us now turn to the economic impact of Federal expenditures as revealed by the income and product accounts. Exhibit 2 shows a breakdown of the expenditures into purchases of goods and services and other items.

In this table I have brought back these expenditures by quarters to 1957.

From the fourth quarter of calendar 1957 to the corresponding quarter of 1958, Federal Government purchases of goods and services increased by more than \$4½ billion to nearly \$54 billion at an annual rate. In addition to the rise in national defense expenditures, greater outlays were made for such purposes as the farm price support operations and the pay raise for Federal employees.

It is expected that Government purchases of goods and services in the first half of 1959 will be at an annual rate close to \$55 billion, with national defense expenditures accounting for practically all of the increase over the fourth quarter 1958 rate.

The budget implies that for fiscal 1960 Government purchases of goods and services will total \$54 billion, representing no marked change in the course of that year. Compared with the rise of more than \$4 billion in purchases from fiscal year 1958 as a whole to fiscal 1959, the present budget implies no great change.

Total expenditures for categories not included in goods and services—that is, transfer payments, grants-in-aid, interest payments, and subsidies less surplus of Government enterprises—were at an annual rate of nearly \$37 billion in the fourth quarter of calendar 1958. The budget implies that this figure will rise by \$1 billion in fiscal 1960, following the \$4 billion increase from fiscal 1958 to fiscal 1959.

A substantial part of the contemplated \$4 billion 1959 rise is expected to be in transfer payments to individuals and in grants-in-aid to the State and local governments. A much smaller increase is projected for these items in fiscal 1960.

Transfer payments moved ahead rather sharply in fiscal 1958 from an annual rate of nearly \$17 billion in the third quarter of calendar 1957 to nearly \$22 billion in the fourth quarter of calendar 1958. Part of this increase was due to the rise in unemployment compensation benefits accompanying the decline in business. Transfer payments in total are expected to rise by only one-half billion dollars from fiscal 1959 to fiscal 1960. The composition of the payments will change, however, as unemployment compensation payments decline and are offset by a rise of \$1½ billion in other transfer, mainly in increased benefit payments under the social insurance system.

Another item is the decline in subsidies less current surplus of Government enterprises from a total of \$4 billion for fiscal 1959 to \$3½ billion in fiscal 1960. This budgeted decline comes about mainly as a result of anticipated reductions in payments to farmers under the soil bank program, and the proposed increase in postal rates designed to minimize the Post Office operating deficit.

The budget submitted for 1960, therefore, implies no significant change in the purchases of goods and services from the current rate and only a modest increase in all other types of expenditures. Loans and other capital transactions as reflected in the administrative budget are estimated to decline rather sharply in fiscal year 1960.

Underlying the \$77.1 billion of Federal Government receipts for fiscal year 1960 are the assumptions, as stated by the Secretary of the

Treasury, of $374 billion of personal income and corporate profits of $47 billion. Both of these figures are for the calendar year 1959. These estimates compare with an annual rate of personal income of $359½ billion last December, and an annual rate of corporate profits approximating $44 billion in the fourth quarter of last year.

The latest official estimate of corporate profits for the third quarter of calendar 1958 at an annual rate of $38 billion was published in the Survey of Current Business, Department of Commerce, January 1959. It is quite certain that as a result of the substantial rise in business activity in the fourth quarter, corporate profits are substantially above those of the third quarter.

In the framework of the national income and product accounts, the budget implies that the total receipts in fiscal year 1960 will be 93.5 billion, a rise of $9 billion from the estimate for fiscal year 1959. This is about the same as that shown by the administrative budget receipts. As exhibit I indicates, the trust fund receipts rise by about $3 billion from fiscal 1959 to fiscal 1960 while the excess of corporate tax accruals over tax collections drops by $2½ billion. These are the two large items which make up the difference between the administrative budget receipts and those based on the national income and product accounts.

Comparing the estimated expenditures and receipts in the national income and product accounts, the indicated surplus is $1½ billion in fiscal 1960 compared with a deficit of $6½ billion in the current fiscal year.

In summary, the budget implies that total Federal expenditures will not differ substantially in the forthcoming fiscal year from the current rate, but that revenues will rise with continued improvement in business activity.

Receipts and expenditures of State and local governments in the aggregate have risen every year in the postwar years. In the past 5 years, the average rise in expenditures—on national income and product account—was $3 billion per year; the increase in receipts averaged $2½ billion per year.

For the year ahead, estimates of expenditures and receipts of State and local governments are more tenuous than the Federal estimates since there are no summaries of budgets available as is the case for the Federal Government. Based on fragmentary information and using past trends as general guides, it is assumed that purchases of goods and services by these governments will continue to rise more or less in line with the recent trend.

Expenditures of State and local governments—on national income and product account—in fiscal 1958 amounted to $41 billion; they are calculated at $44 billion in fiscal 1959 and $48 billion in fiscal 1960. Purchases of goods and services, which totaled $38 billion in fiscal 1958, may be expected to increase by $3½ billion in fiscal 1959 and by $3 billion more in fiscal 1960 to a total of approximately $44½ billion. Increased outlays for construction, particularly schools and highways, and higher employee compensation, will account for almost all of these advances.

State and local revenues are expected to rise as a result of improved business conditions. Principal sources of the higher receipts are increases in personal income taxes, in property and sales taxes, and some rise in grants-in-aid from the Federal Government. Total receipts of State and local governments on national income and product account were $39 billion in fiscal 1958 and are estimated to be $42½ billion in fiscal 1959 and $46 billion in fiscal 1960.

Taking into account the higher expenditures, it would appear that these governments are likely to incur about the same deficit in the aggregate as the average of recent years.

The trend of the combined expenditures of Federal, State, and local governments will be upward throughout the coming fiscal year. This rise during the next 12 months, however, would come almost entirely from State and local governments.

For the fiscal year 1958, total Government purchases of goods and services were $88 billion; these are projected to $95½ billion in fiscal 1959, and to $98½ billion in fiscal 1960. On a calendar year basis, Government purchases of goods and services are expected to rise from the total of $91 billion in 1958, to $97½ billion in 1959.

In summary, for all governments combined, Government receipts in fiscal 1960 will be about in balance with Government expenditures. The indicated surplus of $1½ billion in the national income accounts for the Federal Government would be offset by the expected deficit for State and local governments.

(Exhibits 1 and 2 follow:)

EXHIBIT 1.—*Federal Government receipts and expenditures: Administrative budget, cash budget, and national income and product account, 1958–60*

[Billions of dollars]

| | Fiscal years | | |
|---|---|---|---|
| | 1958 actual | 1959 | 1960 |
| | | Estimated | |
| Receipts: | | | |
| Administrative budget | 69.1 | 68.0 | 77.1 |
| Plus: Trust fund receipts | 16 3 | 17.6 | 20.5 |
| Less: Intragovernmental transactions and other adjustments | 3.6 | 3.9 | 4.1 |
| Equals: Cash receipts from the public | 81.9 | 81.7 | 93.5 |
| Plus: | | | |
| Excess of tax accruals over tax collections 'corporate | −2.3 | 4.0 | 1.5 |
| Miscellaneous adjustments [1] | −1.2 | −1.2 | −1.5 |
| Equals: National income and product account receipts | 78.3 | 84.5 | 93.5 |
| Expenditures: | | | |
| Administrative budget | 71.9 | 80.9 | 77.0 |
| Plus: | | | |
| Trust fund expenditures | 16.1 | 18.9 | 20.3 |
| Government-sponsored enterprise expenditures (net) | −.6 | .9 | .1 |
| Less: Intragovernmental transactions and other adjustments (including IMF notes) | 4.0 | 5.7 | 4.5 |
| Equals: Cash payments to the public | 83.4 | 94.9 | 92.9 |
| Less: | | | |
| Loans and other capital transactions | 1.5 | 3.9 | 1.1 |
| Miscellaneous adjustments [2] | −.6 | .0 | −.2 |
| Equals: National income and product account expenditures | 82.5 | 91.0 | 92.0 |
| Surplus or deficit (−): | | | |
| Administrative budget | −2.8 | −12.9 | .1 |
| Cash budget | −1.5 | −13.2 | .6 |
| National income and product account | −4.2 | −6.5 | 1.5 |

[1] Includes such receipts as those of the District of Columbia, contributions to Federal retirement funds, and receipts of capital items like repayment of loans.

[2] Includes such expenditures as those of the District of Columbia, Government-sponsored enterprises, contributions to Federal retirement funds, and accrued interest on savings bonds and Treasury bills.

Source: Administrative and cash budgets from the budget of the U.S. Government for the fiscal year ending June 30, 1960; national income and product account data from the U.S. Department of Commerce, Office of Business Economics, data for 1959 and 1960 based on estimates in the budget.

EXHIBIT 2.—*Federal Government expenditures on national income and product account, 1957–60*

[Billions of dollars]

| | 1957 | | | | 1958 | | | | 1959 [1] | | 1960 [1] | Fiscal years | | | Calendar years | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | I | II | III | IV | I | II | III | IV [1] | 1st half | 2d half | 1st half | 1958 | 1959 [1] | 1960 [1] | 1957 | 1958 [2] | 1959 [1] |
| Total expenditures | 77.7 | 80.1 | 79.9 | 80.8 | 82.8 | 86.0 | 88.7 | 90.6 | 92.3 | 91.8 | 92.0 | 82.5 | 91.0 | 92.0 | 79.6 | 87.0 | 92.0 |
| Purchases of goods and services (less sales) | 49.1 | 49.7 | 49.7 | 49.1 | 49.7 | 50.7 | 52.2 | 53.8 | 55.0 | 54.0 | 54.0 | 49.7 | 54.0 | 54.0 | 49.4 | 51.6 | 54.5 |
| National defense | 43.7 | 44.9 | 44.9 | 43.9 | 43.7 | 44.1 | 44.5 | 45.0 | 46.0 | 45.5 | 45.5 | 44.1 | 45.5 | 45.5 | 44.3 | 44.3 | 45.7 |
| Other expenditures | 28.6 | 30.5 | 30.2 | 31.8 | 33.0 | 35.4 | 36.5 | 36.8 | 37.2 | 37.8 | 38.0 | 32.6 | 37.0 | 38.0 | 30.1 | 35.4 | 37.5 |
| Grants-in-aid | 3.9 | 3.8 | 4.3 | 4.4 | 4.4 | 4.8 | 5.4 | 6.0 | 6.2 | 6.4 | 6.6 | 4.5 | 5.9 | 6.5 | 4.1 | 5.1 | 6.3 |
| Transfer payments | 16.0 | 17.8 | 17.1 | 18.6 | 19.5 | 21.5 | 22.1 | 21.7 | 21.0 | 21.7 | 22.1 | 19.2 | 21.4 | 21.9 | 17.3 | 21.2 | 21.3 |
| To persons | 14.6 | 16.0 | 15.9 | 17.2 | 18.3 | 20.3 | 20.9 | 20.5 | 19.8 | 20.5 | 20.9 | 18.0 | 20.2 | 20.7 | 15.9 | 20.0 | 20.1 |
| To abroad | 1.4 | 1.8 | 1.2 | 1.4 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.5 | 1.2 | 1.2 |
| Interest | 5.5 | 5.7 | 5.7 | 5.7 | 5.7 | 5.7 | 5.6 | 5.6 | 5.6 | 5.9 | 6.3 | 5.7 | 5.6 | 6.1 | 5.6 | 5.7 | 5.8 |
| Subsidies less current surplus of Government enterprises | 3.2 | 3.2 | 3.1 | 3.1 | 3.4 | 3.4 | 3.4 | 3.5 | 4.4 | 3.8 | 3.0 | 3.2 | 4.0 | 3.5 | 3.1 | 3.4 | 4.2 |

[1] Estimated.
[2] Preliminary.

Source: U.S. Department of Commerce, Office of Business Economics. Data for 1957 and 1958 are actual; data for 1959 and 1960 are based on estimates in the "Budget of the U.S. Government for the Fiscal Year Ending June 30, 1960."

The CHAIRMAN. We are happy to welcome back Mr. Robinson Newcomb who is going to discuss housing investment and demands.

Mr. NEWCOMB. Thank you, Mr. Chairman.

## STATEMENT OF ROBINSON NEWCOMB, CONSULTING ECONOMIST, WASHINGTON, D.C.

Mr. NEWCOMB. Mr. Chairman, the Office of Business Economics of the Department of Commerce has just made data available to the Senate Banking and Currency Committee on trends in family and household income distribution. Unfortunately, these data were not presented in such form as to show in constant dollars what has been happening to the number of families of a given purchasing power.

The figures suggested that the number of households with incomes over $7,500 per year in 1957 dollars was rising relatively faster than the number with incomes under $7,500 and that there has been a decline in the number with incomes under $5,000.

But the data were not clear. I accordingly put staff on the problem of translating the data made available to the Senate Committee into constant purchasing power tables. The resulting tables showed that the number of households with incomes under $5,000 in 1957 values rose through 1949, but has been declining since. The number with incomes from $5,000–$7,500 has been rising very appreciably. The rise in the number with incomes above $7,500 is quite startling.

Facts on the shift in income distribution are very pertinent to any study of the housing market because the absolute growth in the number of households now represents only roughly half the housing market. The upgrading of housing standards represents the other half today.

If 20 percent of the population upgrade their housing about 10 percent a year—and this is not far from what appears to be happening—the housing market would grow 2 percent, or about a million units per year, even though there were no increase at all in the number of households. That could mean that 2 percent of 50 million families, or 1 million families, move to better houses each year. They could abandon roughly 1 million houses.

Actually, of course, we do not abandon a million units a year. Housing is upgraded by improvement of existing stock as well as by abandonment of existing stock. The amount of the improvement depends in part on the cost of new versus the cost of improving the old.

The census has recently revised upward its estimate of the probable number of households that will be found in 1960. The desire of people to have good homes and their ability to pay for homes is such that the number of households is rising even more than some have expected, and housing standards also are being improved more than some had anticipated.

The markets to which I am referring have little reference to the needs of the lowest income groups—those without wage earners, those on inadequate pensions, families whose wage earner is incapacitated by sickness or accident, and families living on substandard farms, among others. The need for what has been called compassionate housing is a separate matter. I am referring here merely to the investment market for housing.

When the market resulting from the increased number of households—about 800,000 per year—is added to the market resulting from upgrading of income—not far from 800,000 a year, there would appear to be an effective demand for something like 1½ million units per year over an extended period of time. Such a demand would appear to be with us today.

Demand makes its appearance, of course, only when it can be translated into contracts for purchase or for rent. If the contract calls for a large downpayment or for rapid amortization or high monthly payments, the market is reduced. It should be noted that easy-term home purchase contracts have proved to be good contracts. We don't get excited when a family rents and pays only 1 month's rent in advance. The mortgage behind a property being rented is not imperiled because the tenant may leave at any time.

The mortgage behind a house bought with a small downpayment is not a hazardous risk either because the purchaser can walk out at any time. The purchaser does not walk out. He is proud of his house. He improves it—he spends time and money on landscaping the outside and on fixing up the inside. The basic question is: Is he an honest man; can he afford the monthly payments? The basic question is not: Was the downpayment low?

My comments about the size of the market being in the neighborhood of a million and a half are, therefore, based on the assumption that families able to pay for housing will not be denied housing because they cannot make a large downpayment.

Adequate mortgage financing cannot be secured without ready access to savings of the country. Housing funds are being denied access to current savings. Increasing proportions of savings are coming in the form of internally generated corporate funds, time deposits in commercial banks and pension funds. Corporations invest almost nothing in housing. Commercial banks make a relatively small volume of new housing loans, and pension funds make almost none.

Pension funds at least could be tapped very readily. Unless FNMA is willing to sell long-term debentures, it is difficult for pension funds to invest in FHA mortgages, but they could lend funds to savings and loan associations. A 10-year loan to a savings and loan association would be guaranteed by the Savings and Loan Insurance Corp., and, therefore, would be a good investment for the pension funds. Because this loan would not have to be backed by high reserves in the savings and loan association, a higher than usual percentage of it could be invested in mortgages. This is true because reserves must be maintained against deposits by savings and loans just as reserves must be maintained by banks to enable them to pay off depositors if requests for payment are made. No such reserve would be required against a loan made by a savings and loan so the money could go to mortgages.

The cost of handling a million dollar loan is far less than the cost of handling 1,000 $1,000 deposits, so the overhead in handling this money would be less. This means that the spread between the interest rate paid on the loan from the pension fund and the interest charged on mortgages to home buyers could be less than the spread between interest paid depositors and interest charged mortgagors. And the augmented flow of funds to mortgages would help to hold down the interest rate for mortgages, as well as increase the amount of housing that could be built.

With a big demand for housing, and if the institutional framework of the savings and loan system can be adjusted quickly to enable savings and loans to borrow directly and competitively in the money markets, it would seem that the volume of housing in 1959 should equal or exceed 1.3 million. If action is taken in the savings and loan field promptly, the number might rise appreciably above 1.3 million in 1959, and still higher in 1960.

The market for housing is strong. The money is available if it can be tapped. So it would appear that the housing volume in a free market should exceed 1.3 million units in 1959. Should improved access to trust funds be denied and higher interest rates reduce the volume of FHA financing, the volume could drop below a 1.1 rate by late fall.

The following table, taken from the latest SEC release on the subject, shows how individual savings have grown in institutions other than savings and loans compared to the growth in savings through savings and loans. The growth in time and savings deposits of banks in the third quarter of 1958, for instance, was 392 percent of the growth in savings and loans. New sources of funds must be tapped for housing.

*Growth in savings by individuals in the United States, ratio savings and loan to other savings*

[1955 ratio savings and loans to others=100]

| | 1955 | 1956 | 1957 | 1958, July-September [1] |
|---|---|---|---|---|
| Time and savings deposits | 100 | 123 | 210 | 392 |
| Investment company shares | 100 | 112 | 125 | 343 |
| Pension funds and reserves | 100 | 106 | 126 | 222 |

[1] Not seasonally adjusted.

Mr. NEWCOMB. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

The discussion will be continued by Martin R. Gainsbrugh, chief economist, National Industrial Conference Board, who will speak on the subject of investment demand.

Mr. GAINSBRUGH. I ask your indulgence for having to leave directly after my testimony. I have a conference in Phoenix tomorrow and must fly out there.

## STATEMENT OF MARTIN R. GAINSBRUGH, CHIEF ECONOMIST, NATIONAL INDUSTRIAL CONFERENCE BOARD

Mr. GAINSBRUGH. My remarks will be directed first to the short-term outlook for private capital investment. As to the near-term, the National Industrial Conference Board's survey, sponsored by Newsweek, of capital appropriations approved by large manufacturing concerns provides considerable insight. Two significant conclusions emerge: (a) preliminary evidence from our fourth-quarter capital appropriations reports confirms the modest upturn in appropriations first evident in the third quarter.

It is still true, however, that capital spending as late as the fourth quarter of 1958 was still declining, at least in manufacturing, the Council of Economic Advisers to the contrary.

(b) On the basis of past relationships between appropriations and subsequent spending, it is likely that private investment in plant and equipment may begin to accelerate in late 1959 at a time when other important initial stimuli to recovery are waning.

The CHAIRMAN. Then you do not expect this acceleration to take place until toward the end of 1959?

Mr. GAINSBRUGH. Yes, the second half, as compared with the first.

The past year has indicated again that once a decline in plant and equipment outlays sets in, it continues for at least a year or more, as I stated a year ago.

You recall that last year I said I was not a member of the Six Months Club.

Similarly, I now suggest that once an upturn sets in, it also should continue for a rather prolonged period. Once the bottom is actually established in this vital sector, and an upturn is clearly evident, the rise in spending for plant and equipment may well continue for as much as 2 years.

The rationale for the recovery and the possible extent to which it might carry should be related to three important factors: The relation of output to capacity, the flow of profits and depreciation allowance, and our changing technology in relation to business and Government outlays for research and development.

There is now a general consensus of professional opinion that the recent recession was triggered by a decline in capital spending. Thus the Economic Report states:

> The major developments (in 1957) were the decrease in the volume of incoming business of the capital goods industries and reduced appropriations by manufacturing businesses for their investment expenditure programs. By the end of 1957, these early signs were confirmed by lower expenditures of business concerns on machinery, equipment, and new facilities.

After the fourth quarter of 1956, both industrial production and GNP, in real terms, failed to rise at a time when major investment outlays were substantially increasing the Nation's capacity to produce. That there were significant areas of the economy characterized by excess capacity at the 1957 peak of the cycle is confirmed by the work at the Conference Board on capital output ratios, as well as the surveys conducted by McGraw-Hill and the analysis prepared by Fortune magazine.

Capacity, of course, has grown over the 2 years since the 1957 peak in business. My remarks to this committee a year ago are still pertinent: "The working off of this unused capacity will take some time, measured in terms of a year or more, not in terms of a few months." If the capacity problem were the only element in the capital goods picture, one would not be as optimistic about the imminence and extent of the recovery in this critical sector.

Current and prospective corporate profits now represent a much more compelling impetus to the initial phase of recovery in capital goods spending. With the recent sharp increase in productivity, corporate profits in the fourth quarter of 1958 rebounded to $44 billion, annual rate, almost to the prerecession peak. If the Federal budget's assumption of $47 billion in corporate profits for 1959 proves to be correct, it will represent a new high in absolute terms.

The note I have appended shows that in relative terms, high as the $47 billion corporate profit is, it is well below the 9 percent of GNP in 1950 and no greater than 5 percent of GNP in 1957.

Add to this the record rate of cash flow resulting from rising depreciation allowances and the result may well be a recordbreaking fund available for capital goods spending. Clearly this will have an impact on decisions to spend; namely, capital appropriations. These, in turn, will become translated into capital outlays at a later date.

(The note referred to follows:)

NOTE.—The rate of profit on equity and sales is still well below prerecession highs. Return on equity third-quarter 1958 was 9 percent; on sales, 4.4 percent. Although this was further improved in the fourth quarter, it is still well below peak profit performance of past decades (e.g., 6 percent on sales, 1947–51, peak 7.6 percent, third-quarter 1950 or 14 percent on investment, 1947–57, and 17.6 percent peak, third-quarter 1950). Fourth-quarter 1958 profits were equivalent to 5.8 percent of national income as compared with 6 percent for all of 1957 and 10.5 percent in fourth-quarter 1950, the peak. If profits reach $47 billion before tax in calendar 1959, as Treasury estimated, $23.1 billion after tax, they will be equivalent to 4.9 percent (after tax) of $470 billion GNP, as Treasury estimated. This compares with $21.8 billion profits equivalent to 5 percent of GNP in 1957 as a whole and 9 percent in the fourth-quarter 1950 high.

That this jump in profits occurred in the face of continued wage increases is eloquent testimony to the efficacy of earlier capital investment in boosting productivity. In this view, the recent rise in productivity and profits is a direct result of the earlier investment boom. Not only does the boost in profits mean an increased flow of funds available for new investment; it also provides a visible proof of the profitability of such investment.

Profits are also linked to our dynamic technology. The continuing rise in outlays for research and development has attracted wide attention. These outlays pay off in greater productivity, new products, and hence more profits. Past increases in research and development will be constantly creating new investment opportunities. This may explain, at least in part, why investment did not fall as far, or as long, during the recent recession as might have been expected solely on grounds of capacity. The past year was no exception in the steady rise in these outlays for the future. They should bear fruit particularly in a period of prospective rise in the flow of funds available for investment.

The pattern of plant and equipment spending has an important time dimension which may prove to be of growing importance in maintaining and sustaining the recovery in the latter part of this year. As the demand for housing ebbs from the current or prospective peak rates, as the impetus from the inventory sector wears off, as Federal outlays stabilize or even drop modestly, the capital goods sector should be ready to provide upward momentum. In fact, this is what happened in previous cycles. The capital goods industries do not lead the cycle upward, as has been too often mistakenly asserted. These industries are most important in giving body to the recovery, and perhaps even laying the groundwork for a boom.

In the presently prospective recovery of plant and equipment, the equipment part should receive the initial boost. Modernization and improvement of facilities will come first.

I would put the sector labeled "Producer's Durable Equipment" figure for the fourth quarter of 1959 at about $26 billion. The figure currently is around $22½ or $23 billion.

After the previous peak in the economy has been surpassed, and by more than a nominal margin, spending for further physical capacity should follow.

It is important to keep this capital goods recovery in perspective. It may not yet even have begun. Thus, we should not expect too much from this sector of the economy, certainly in the first half of this year. In the second half, however, the appropriations data strongly support a sustained rise in capital goods spending by private industry.

By way of review in the earlier 1953–54 business recession, the seasonally adjusted rate of capital appropriations touched bottom in the first quarter of 1954, 1 year before the trough in actual capital outlays.

Capital appropriations rose continuously from early 1954 to the first half of 1956. In this upsurge of capital goods demands, very sizable appropriations backlogs were built up. The 1956 turning point in appropriations again led the decline in spending by a year or more. The capital appropriations' decline in the third quarter of 1957 was particularly steep, and, considered in light of the previous declines in 1956–57, presented a strong argument for an imminent fall in outlays for capital goods.

The spending drop in the fourth quarter of 1957, which first became evident in the Commerce-SEC survey of spending intentions published in March of last year, came as no surprise to followers of the appropriations survey. The subsequent spending slump in the first half of 1958 was also understandable in view of the previous decline in capital appropriations.

The behavior of the Commerce-SEC survey over this period deserves some comment. As you know, these data are presented three times for each quarter. The first capital-goods anticipation is based upon replies made before the quarter has begun. The second anticipation is based upon replies made while the quarter is in progress. The third presentation is based upon historical evidence for the quarter.

The early anticipations of the quarterly figures overstated the actual spending drop in every quarter of 1958. In fact, in each of the 10 quarters ending with the third quarter of 1958, the early anticipation of manufacturing capital investment has been greater than the actual outcome.

The mean, or average, overestimate, for the first anticipation of each quarter was $0.83 billion. Further, the second anticipation for the fourth quarter spending rate in manufacturing has been an overestimate in each of the past 6 years; the average error has been $0.60 billion, at annual rate.

In view of this past experience, it should not be surprising that we have some reservations about the presently predicted rise of $0.27 billion (annual rate) in capital spending by manufacturers scheduled to take place in the first quarter of 1959. In this connection, it should be noted that national product tables presented in the President's Economic Report attach to the estimates of nonfarm producers plant and durable equipment for the second, third, and fourth quarters of 1958 the following footnote:

Data for the last three quarters of 1958 have not been revised to reflect lower expenditures reported in the last two surveys of business expenditures for new plant and equipment.

In passing, I would also like to call attention to the overstatement in capital spending by the public utilities in the early anticipations, compared with the actual Commerce-SEC figures available after the quarter was over, for each of the first three quarters of 1958. At the Conference Board we are looking forward this year to the collection and publication of capital appropriations for the gas, electric, and communications utilities, as an addition to our established series on manufacturing appropriations.

Our manufacturing capital appropriations series touched bottom in the second quarter of 1958. In the third quarter, capital appropriations rose moderately, cancellations fell, and, perhaps most important of all, the number of companies reporting higher appropriations rose sharply.

The decline in backlogs of unspent appropriations in the third quarter was the smallest of the previous six quarters. We have interpreted these findings as indicating a turnaround in capital appropriations, to be followed by a rise in spending some three or four quarters later. The spending decline in the fourth quarter, now reported in the Commerce-SEC series for manufacturing, may well be followed by a further decline of modest proportions in the current quarter.

We are now collecting the capital appropriations report for the final quarter of 1958. While only 100 company reports have been tabulated, the preliminary indications suggest a continued modest rise in appropriations, accompanied by a small decline in capital spending by these large manufacturing concerns.

The evidence for an upturn in capital goods spending is also confirmed by the McGraw-Hill Survey of annual capital budgets collected last October. They indicated a 3-percent decline in manufacturing capital outlays for 1959, compared with 1958, with a counterbalancing increase in the nonmanufacturing sector. Total business spending for plant and equipment this year was accordingly expected to be about the same as last.

This anticipated equality of spending in the 2 years implies that during the coming 12 months, the rate of spending will rise. This follows from the downward revision in capital spending we expect for the fourth quarter in the Commerce-SEC series, so that the spending rate at the start of this year will be well below the 1958 average.

The rise in capital-goods spending also follows from the recent upward slope in the capital-appropriation figures. The presently available information both from the spending intentions data and from the capital-appropriation figures suggests that the rise in the early quarters will be of moderate dimensions.

For some perspective on capital goods, I propose to review briefly the three postwar cycles in plant and equipment spending, using two charts we have prepared from the Commerce-SEC data. For each of the three cycles, 1948–53, 1953–57, and 1957 to date, we have set the prerecession peak in the capital-outlay series equal to 100. It is now clear that the 1957–58 decline in capital-goods spending was more severe than in the earlier postwar business recessions. In the 1948–49 cycle, the trough of the plant and equipment spending series coincided with the trough in general business activity. However, in the 1953–54 and the most recent cycle, the trough in business spending came later than the bottom in general business.

Even more interesting from our present viewpoint was the snapback in plant and equipment outlays in the two previous recessions. When the trough of the present cycle in capital goods spending becomes clearer, the uptrend may again resemble the recovery pattern of the two previous cycles. Further, once this recovery gets underway, it may continue for a number of quarters.

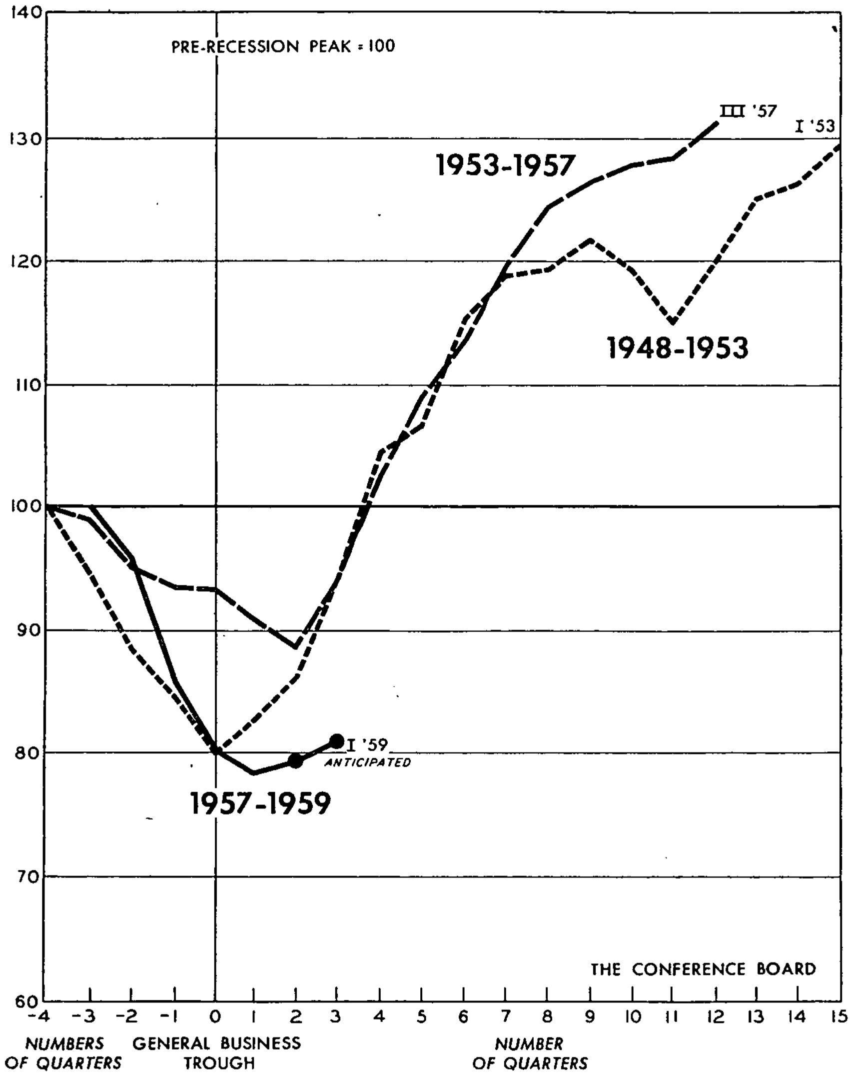
Thus, after the fourth quarter of 1949 trough in plant and equipment spending, recovery continued, with an interruption in 1952, for 15 quarters. The second time around, the recovery continued for 10 quarters after the bottom was reached in the first quarter of 1955. In constant dollars, using the new deflators recently released by the Commerce Department, the 10 quarters of the more recent recovery were reduced to 6 quarters, with the subsequent 4 quarters continuing at peak rates.

The cycles in manufacturing plant and equipment outlays generally followed the same patterns as overall business spending for capital goods. In all three cycles, the trough in manufacturing plant and equipment came well after the bottom in general business activity.

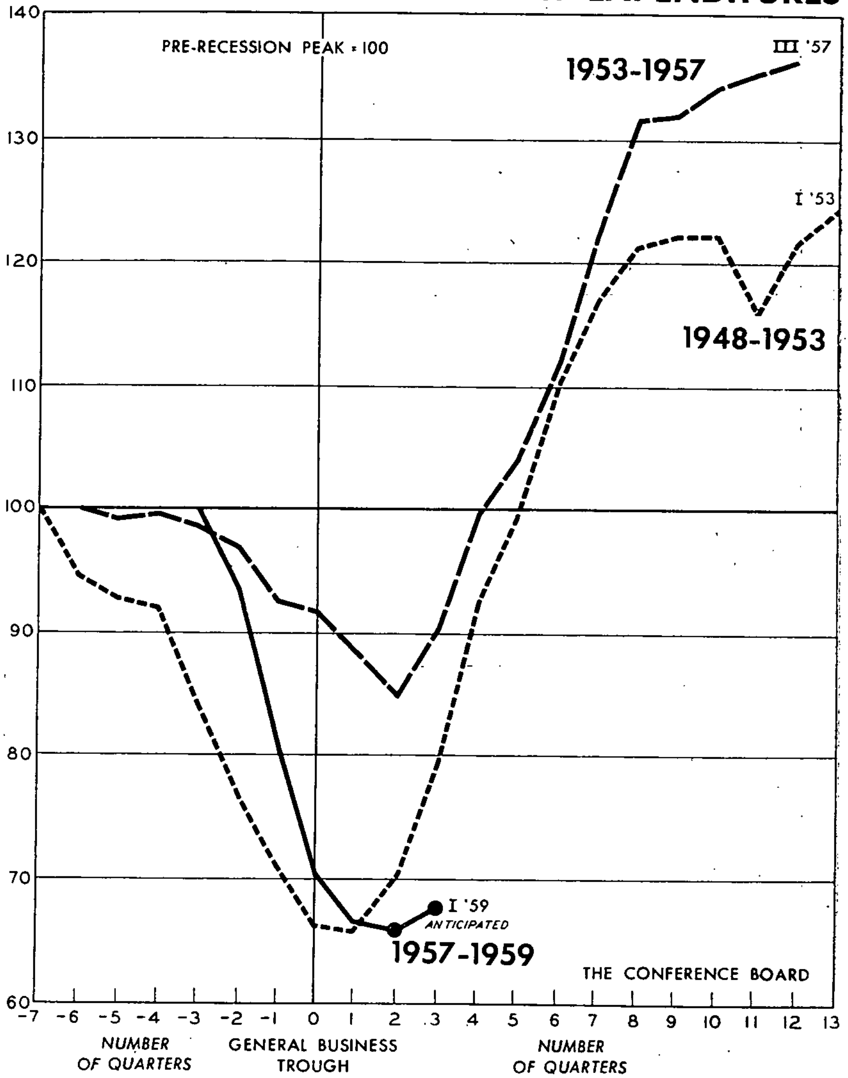
Thank you.

(The charts accompanying Mr. Gainsbrugh's statement follow:)

THREE CYCLES IN BUSINESS PLANT & EQUIPMENT EXPENDITURES



## THREE CYCLES IN MANUFACTURING PLANT & EQUIPMENT EXPENDITURES



The CHAIRMAN. Mr. Gainsbrugh, we are very happy that you are here. We wish you a pleasant journey into the sunshine and that you may enjoy the mild climate of Arizona.

Thank you.

The next participant is Mr. Irwin Friend, professor of economics, University of Pennsylvania, who is going to speak on the general topic of economic outlook for 1959.

Mr. FRIEND. Thank you, Mr. Chairman.

## STATEMENT OF IRWIN FRIEND, PROFESSOR OF ECONOMICS AND FINANCE, UNIVERSITY OF PENNSYLVANIA

Mr. FRIEND. I have been asked to comment on the economic outlook for 1959 with particular reference to prospective trends in inventories and consumption. I might say at the outset that my analysis of all the major factors likely to affect the national income this year has led me to pretty much the same conclusion which most other economists both inside and outside the administration seem to have reached.

The year 1959 will probably be characterized by rising economic activity and on the basis of plausible assumptions should achieve a level of gross national product of over $470 billion for the year as a whole and an annual rate of over $480 billion in the fourth quarter.

In my opinion, the analysis suggests rather little pressure on prices over the year and a level of unemployment at the end of 1959 somewhat lower than the current level. However, I do not anticipate a return to full employment conditions by the end of the year in view of rises in productivity and in the labor force.

The basic assumptions behind these projections are an increase in Federal and more important in State and local government expenditures on income and product account of close to $4½ billion from the fourth quarter of 1958 to the fourth quarter of 1959, no change in tax rates, an increase in nonfarm plant and equipment expenditures of some $3½ billion—or 10 percent—over the same period and moderate and offsetting changes in residential construction, farm investment, and net exports.

I might note that my estimate of Federal expenditures is about a billion dollars higher than would seem to be implied by the administration budget.

On the basis of these assumptions in other sectors of the economy which presumably will be discussed in detail by other witnesses before this committee, I estimate that the annual rate of inventory investment will increase by more than $5 billion from the fourth quarter of 1958 to the fourth quarter of 1959, and consumption by roughly $15 billion.

Inventory investment can be regarded as one of the more dependable as well as one of the more important mainstays of economic activity this year. There are basically three different approaches to predicting the course of inventory investment from the end of 1958 to the end of 1959.

The first is simply to note what happened in corresponding periods of recovery from earlier inventory recessions; for example, the move in inventories from the end of 1954 to the end of 1955. The second is to make use of the statistical relationship observed between the rate of inventory investment and the rate of change in sales some 6 months earlier; the lag represents the time it takes for businessmen to adjust their inventories to the desired relation with sales and permits knowledge of current sales to be translated into inventory movements a half year or so later.

The third approach which is theoretically the most appealing is to ask a sample of businessmen either about their inventory plans and sales anticipations over the year or about their desired relation of inventories to sales as compared with the current situation. Fortune magazine has just completed such a survey of business inventory plans and sales anticipations which it kindly made available for this testimony.

All of these approaches imply that current inventories are already somewhat inadequate and that, as compared to an estimated zero rate of inventory investment in the fourth quarter of 1958, the annual rate should be expected to move rapidly to over $5 billion with rising sales, and be at least at that level during the fourth quarter of 1959 but might easily be $6 billion or more. It appears that most of the increase in inventory investment will occur in durable-goods areas.

More detail on the inventory situation in various industries and at different distributive levels is contained in a brief analysis to appear in the February issue of Fortune magazine which I should like to submit for the record.

Consumption as a whole for the rest of this year seems to me likely to move pretty much as disposable personal income. The rate of personal saving at the end of 1958, estimated at 6 percent of income, is about as low as it has been since 1950. This of course is the same as saying that the current ratio of total consumption to income, which is 94 percent, is relatively high.

Consequently, the consumption-income ratio might be expected to decline somewhat over 1959. It might be noted that there was very little change in this ratio from the fourth quarter of 1954 to the fourth quarter of 1955, which was the corresponding period of the recovery from the 1953–54 recession. However, the consumption-income ratio is currently higher than in the previous upturn and while there is reason to expect that in one major sector of consumption—viz, automobiles—purchases will go up more than proportionately to income there is little reason to anticipate another record year for automobiles like 1955.

The critical assumptions necessary in projecting the rise in the annual rate of total consumption from the fourth quarter of 1958 to the fourth quarter of 1959 involve first the relation between increases in total consumption and in personal disposable income and second the relation between increases in personal disposable income and in gross national product.

On the assumption that the first ratio—the marginal propensity to consume in this period—is roughly 0.9 and the second ratio close to 0.6, the estimated annual rate of increase in total consumption over the year will be approximately $15 billion and the increase in gross national product nearly $30 billion. This may be a fairly generous estimate of the increase in consumption since it implies only a small rise in the saving rate from 6.0 percent to 6.2 percent.

It will be noted that the previous analysis of total consumption relies heavily on past relationships. These relationships imply increases in expenditures on consumption generally, but for most goods and services the percentage increase implied from the rate in the fourth quarter of 1958 is slightly less than in income. On the other hand, a more than proportional increase in automobile expenditures is suggested by past relationships.

Clearly it would be desirable to supplement past relationships by other information including consumer intentions to buy and related anticipatory data. Unfortunately such data of this type as are available are a couple of months out of date and their interpretation is in any case rather difficult.

To sum up, the year ahead seems likely to be prosperous but not inflationary. There is the uncomfortable prospect—but by no means certainty—of a prolonged level of unemployment which though not high by recessionary standards is too high by "full employment" and vigorous growth standards.

This is the type of period where unlike the situation a year ago the dangers of deflation are not necessarily greater than the dangers of inflation though the latter can easily be exaggerated.

As a consequence, appropriate fiscal policy should be reasonably neutral in the sense that any substantial changes in expenditures from those currently budgeted should be offset by corresponding changes in revenues and in the absence of such developments major reliance might well be placed on more flexible monetary policies.

(Fortune article follows:)

[From Fortune, February 1959, "Business Round-Up," pp. 33–40]

INVENTORIES: TOO LOW

The rapidity of the recovery, optimism about sales, expectations of rising prices, and the good possibility of a steel strike would all seem to herald a scurry for more inventory, but it hasn't—yet. Inventories were held fairly steady last quarter. Businessmen answering Fortune's survey of 500 companies on their inventory and sales expectations say they plan to add better than $3 billion, or 4 percent, to inventories during 1959. This looks low with respect to their needs.

Needs, of course, are related to sales expectations and the adequacy of present stocks. Executives in the survey expect total sales of goods to rise by 7 percent during 1959; so final purchases (i.e., sales adjusted to exclude inventory accumulation) would be up nearly 6 percent. They also want 1 percent more inventory relative to sales than they have at present. To reach the inventory-purchases ratio they say they want (see chart p. 33) they would need not $3 billion more inventory but $6 billion.

Current rates of stockpiling are even lower than the $3 billion executives plan and the $6 billion they need. Inventories in general showed little change in the fourth quarter. The January increase in industrial output may have made a start in the direction of accumulation, but probably only a small one (e.g., in steel; see below).

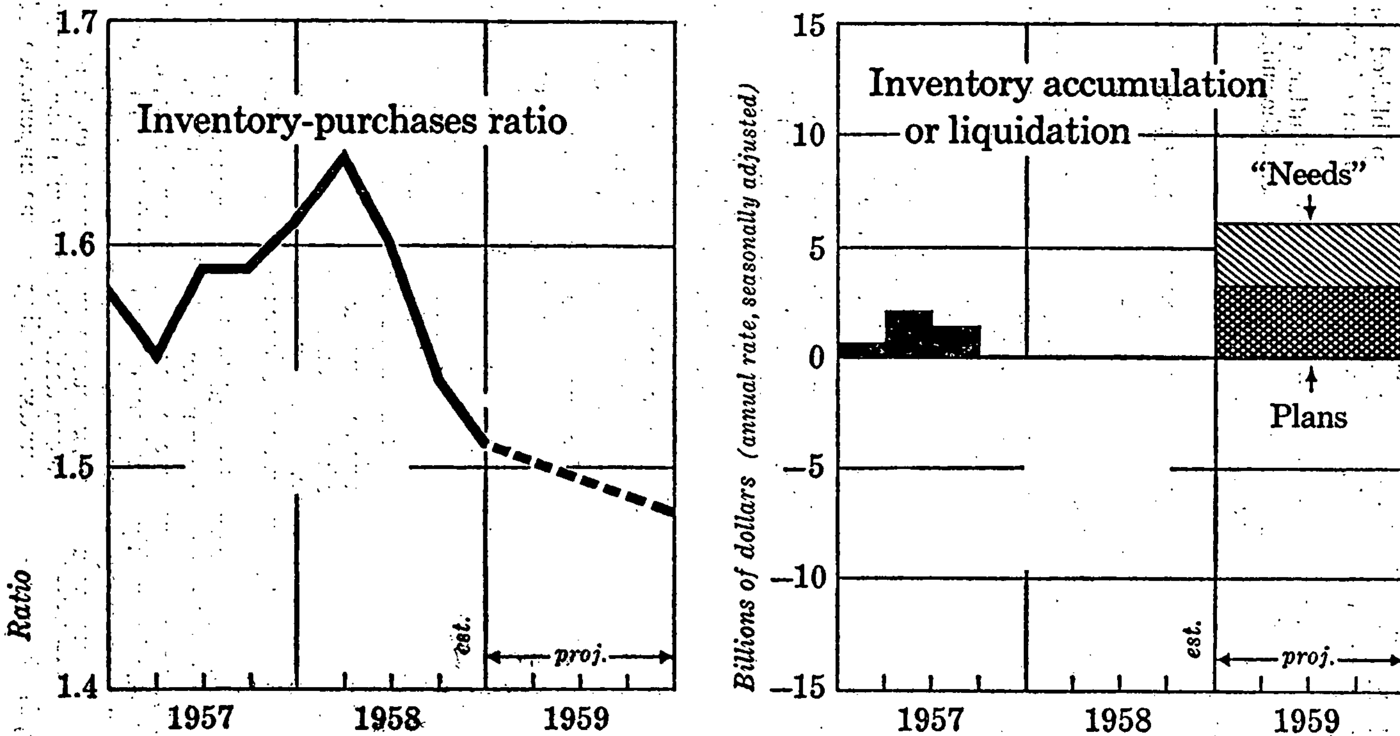
All this is building up a potential shortage of goods, and therefore the likelihood of a belated rush to stockpile in coming months. By now, business may even have as much as 2 percent less inventory than it desires, and it is fast losing its cushion of finished goods, those ready for shipment to customers. As sales pick up in coming months, more shortages will appear. These inventory deficits, of course, are a legacy of the inventory cutting in the recession, which slashed stocks by more than $6 billion, and are concentrated primarily in durable goods lines of business.

In nondurable goods stocks are adequate. Nondurables merchants are presently satisfied with their stocks and plan only a 2 percent rise in the next year ($400 million), in the face of an expected 4 to 5 percent sales rise. Nondurables manufacturers actually claim to have a trifle too much inventory now—a 1 percent excess in oil, paper, and chemicals, and one of 3 to 4 percent in textiles; consequently they plan only a 1-percent rise in stocks ($200 million) during 1959, though they expect sales to be up 4 percent.

But merchants of durables are already short and accordingly they are planning inventory increases in line with sales expectations. Wholesalers, short by 2 percent now, figure on a 1959 rise of 6 percent in stocks ($350 million) and sales. Durables retailers already have 6 percent less stock than desired and so plan on an 11-percent rise ($1 billion), as against a 13-percent increase expected in sales. Car dealers account for by far the largest present shortages and expected gains; they had 590,000 1959 cars in stock at year's end, which was too few by 10 percent in their opinion. So Detroit is exceeding January schedules.

Manufacturers of durables are not planning in line with sales expectations, much less hedging against a midyear steel strike. These producers at yearend figured inventory as a trifle on the low side, having reduced it by $4 billion in 1958, and so eliminated the 8-percent excess reported a year ago. Now they plan an accumulation of less than 5 percent ($1.3 billion) as against an average sales increase of 10 percent expected in 1959 (this is typical of most lines; aircraft companies are less bullish, steel producers more so). This would steadily lower their already low ratio of inventories to sales, without making any provision for a strike.

Inventories Are Low—Plans Are Conservative




Inventories at the end of 1958 averaged 1 percent less than businessmen themselves desired, according to 500 merchants and manufacturers surveyed by Fortune. Executives plan an accumulation this year that would total $3 billion (or 4 percent). But on their own projections of sales, businessmen would need $6 billion more inventory to maintain stocks in the desired relation to sales. And that is what Roundup expects they will buy. Output, obviously, will rise. (Inventory changes from the Department of Commerce; projections and other data by Fortune.)

The CHAIRMAN. Thank you, Mr. Friend.

We will have the article which you mentioned as published in Fortune magazine included in the record at the conclusion of your statement.

The discussion will be continued by Mr. William F. Butler, vice president of the Chase Manhattan Bank, who will discuss the subject of "International Trade Investments."

Mr. Butler.

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

Mr. BUTLER. Thank you, Mr. Chairman.

As I understand my part of this morning's assignment, it is to consider prospects for our international trade and investment during the next year or so. This seemingly clear cut and innocuous statement covers up a great deal. What is really involved is an appraisal of the business outlook in the United States and the rest of the world, a consideration of the many complex factors influencing our balance of payments with the rest of the world, and a judgment as to the validity of the charge that the United States is pricing itself out of world markets.

Stated in this manner the assignment is indeed formidable.

Nevertheless, I feel it is most appropriate that this committee concern itself with these matters, however complex they may appear. For this Nation must be concerned, and increasingly so, with international economic affairs in general as well as with the maintenance of confidence in the dollar.

The fact that we must do so signals the beginning of a new phase in the world economy. Competition in world markets has become more intense, and the vigor of this competition promises to increase in the period ahead. To cope with it, we must strive to increase the technical efficiency of our production and to contain inflationary pressures.

While I have no illusions that the period ahead will be an easy one, I do have confidence in our ability to deal with the problems that we face. In my personal judgment, the U.S. economy is entering a new period of expansion that promises to carry us back to capacity production and a high level of employment by late 1959 or early 1960. It is my view that 1959 will be a year during which the rest of the free world will also witness a return to dynamic economic growth.

Such developments could reduce the outflow of gold from this country to manageable proportions. They could also open very great new opportunities for our export trade and for our oversea private investment.

To realize these opportunities, and in fact to measure up to our responsibilities in the world, we must control inflation. If we should undergo further inflation relative to the rest of the world, many of our products would be quickly priced out of world markets. If not corrected with alacrity, such a trend could lead to a crisis of confidence in the dollar which would have serious repercussions throughout the world. It is my belief that we can deal effectively with inflationary pressures, if there is a broad understanding of the importance of doing so.

Having set forth these conclusions, I feel I should try to present some of the reasons that lie behind them. Trends in our international economic relationships are intimately linked to developments in domestic business. Experience shows that our imports move up and down in general harmony with the business cycle. Our oversea investments too are importantly affected by swings in corporate earnings.

On this score, I believe the immediate outlook is most favorable. Our economy has weathered the third postwar recession in satisfactory fashion—total national output has regained its previous peak. What's more, a realistic appraisal of prospects in key areas of the economy points to a continued, and possibly very strong, advance in the year ahead.

To be specific, here are my projections for major sectors of the economy—the figures cited relate to changes in seasonally adjusted annual rates between the fourth quarter of 1958 and the fourth quarter of 1959.

Government expenditures for goods and services may rise $5 billion, $3 billion at the State and local level and 2 billion at the Federal level.

Business investment in new plant and equipment might rise 10 percent or more—adding $4 billion or more to total demand. By midyear many businesses will be running at an operating rate sufficiently high to make further expansion of capacity desirable.

Housing starts topped the 1.4 million annual rate in December, about as high a level as can be sustained by demand and the flow of mortgage funds. Some moderate decline may set in during the second half, as investors find more attractive outlets for funds than are offered by Government-guaranteed mortgages with their fixed interest ceiling.

Inventory buying promises to add as much as $5 to $6 billion to demand by year's end. The pattern of inventory changes during the year will be importantly influenced by labor-management negotiations in steel.

Consumer expenditures should rise at least $18 billion, or 6 percent. This is about in line with the prospective rise in income after taxes. It assumes sales of 5½ million domestically produced autos, a figure that may well be on the low side by half a million or so.

When you add these projections up, you get a gross national product in the fourth quarter of this year of $485 billion at annual rates. That's an increase of 7 percent during the year—a very rapid advance as compared to the normal 4 percent per annum growth in our economy.

Moreover, I have a feeling that some of my projections may turn out to be too low—particularly those for plant and equipment and for consumption. Thus, I believe it is possible that we'll pass the $500 billion milestone before mid-1960.

This sort of rapid advance in domestic business activity should generate a good increase in our imports. For the year as a whole they may run to $14 billion, up 9 percent from last year. Then our private foreign investment could maintain the 1958 level of $2.8 billion. Corporate earnings will be substantially greater this year than last, while more and more American companies are finding it advantageous to invest abroad. Prospects of a European common market provide an important spur to investment in Europe. These favorable factors will offset the influence of higher interest rates in the United States—and lower rates abroad—which tend to reduce borrowing by foreign governments and businesses in the U.S. market.

All of the items I have just mentioned—imports, services, grants and loans and private investment—supply dollars to other nations. The total supplied this year could run to $27.8 billion, an increase of $1.2 billion over 1958. To forecast our exports, it is necessary to make a judgment as to how many of these available dollars will be spent on exports of U.S. goods and services and how many will go to build up foreign holdings of gold and dollars.

During 1958 shipments of U.S. gold amounted to $2.3 billion and dollar assets held by foreigners rose approximately $1 billion. That was about double the average annual increase in foreign gold and dollar holdings in the 1949–57 period.

Now other nations probably will continue to expand their holdings of gold and dollars in the years ahead—they need to add to their reserves to support expanding trade. In a sense, the free world operates on a dollar standard. But, if the net addition to foreign dollar holdings becomes too rapid, as it was in 1958, and if there should develop a flight from dollars into gold, the world economy would be in serious trouble. That is why it is so important for the United States to maintain its competitive position in world markets.

I do not find any evidence in the available statistics that supports the view that the United States has, as yet, priced its exports out of world markets in any overall sense. Our general price level has not risen in such manner as to move it out of line with that in most other countries. Nor have price trends in any major area of our economy moved out of line.

Nevertheless, it is a fact that U.S. exporters are running into intense competition from foreign suppliers. We have lost business abroad in lines we had pretty much to ourselves until recently. And more foreign producers are invading the U.S. market. Why is this so? For the first time in the postwar period, foreign producers generally have excess capacity. Moreover, many of them have installed modern plant and equipment and have adopted many of our techniques. Thus, they can compete more effectively with us.

Despite these developments, I look for a pickup in our exports as the year progresses. It now looks as though Western Europe is on the verge of a new period of expansion, following a very moderate recession in the United Kingdom and a slowing down or a leveling in a number of other nations.

Such developments could lead to increased demands for U.S. raw materials and semimanufactured products, which accounted for the major share of the drop in our exports.

Moreover, the recovery in the United States and the expansion in Europe promise to increase the foreign exchange earnings of many underdeveloped nations, enabling them to increase their purchases in the United States and Western Europe.

A reasonable projection would place our commercial exports at $18.2 billion for 1959, an increase of 12 percent over last year. Other uses of dollars on the part of the rest of the world for items like shipping, tourism, and earnings remittances should also increase.

On balance, the transfer of gold and dollars to foreign account could be a third less this year than last. Under this projection the rate of the transfer would diminish as the year progresses, a development that would strengthen the dollar and bring the transfer in line with the needs of other nations to bolster their monetary reserves.

Consequently, I believe the immediate problem of the loss of gold and dollars will be reduced to manageable proportions by the recovery in business activity at home and abroad. However, I think we must be concerned about longer term trends in international markets. The prospect for the future is for greater monetary stability in many other nations and perhaps for a greater readiness to devalue currencies to keep competitive.

In addition, other nations are moving ahead rapidly in terms of capital investment and technology, so that they can, with lower hourly wage rates, offer a real competitive challenge in more and more lines.

Given an equal start, I believe U.S. business can continue to hold its own in world markets. The record shows that we have been able to move steadily ahead in developing our technology, so that we have been able to pay higher hourly wage rates, and still keep our overall costs of production on a competitive plane.

It seems to me that our problem can be phrased this way: given the handicap of inflation, U.S. business could run behind in the race for world markets. If we should fail to contain inflation, our domestic costs and prices would rise faster than those in the rest of the world. If that should happen, many U.S. exports would be quickly priced out of world markets.

However, we can give our exporters an even start by taking steps to deal effectively with inflationary pressures. I am aware of the fact that many observers take a dim view of our chances of maintaining a reasonable stability in our price level. However, in my view we can, and must, deal with these problems. We must work to gain broad public acceptance of measures to keep wage increases in line with our ability to pay them without pushing up prices. At the same time, we need to restrain the growth in purchasing power by running a surplus in the Federal budget when inflation threatens, and checking the expansion in money and credit.

It seems, then, quite clear that these goals cannot be attained overnight. Yet by constantly pressing toward them, I believe we can meet the competitive challenge in world markets. Thus, I believe the long-term outlook for our foreign trade and our foreign investments is most favorable.

The CHAIRMAN. Thank you, Mr. Butler.

Mr. Wells.

## STATEMENT OF ORIS V. WELLS, ADMINISTRATOR, AGRICULTURAL MARKETING SERVICE, DEPARTMENT OF AGRICULTURE

Mr. WELLS. I will summarize very briefly the outlook for agriculture in 1959 as presented at our 36th Annual Agricultural Outlook Conference held last November. These conclusions were based on the prospect for a growing economy and a continued strong demand for food in the year ahead. Subsequent developments in this as well as other factors affecting the agricultural outlook have not altered the conclusions reached at that time. As in previous years, I am offering for the record one table and three charts which document some important trends in agriculture.

First, with respect to the price outlook, we expect that prices received by farmers may average some lower in 1959 than in 1958, but probably not far from the current level (table 1). Last year prices averaged 5 percent higher than in 1957, substantially a result of higher prices for hogs and cattle. Prices of most major crops averaged lower.

More recently prices have eased and at the end of the year averaged only slightly above yearend 1957. For 1959, the major price change in view is lower prices for hogs, which are already coming into increasing supply. But we do not anticipate the disorganized markets that prevailed in late 1955. Cattle prices should remain strong as ranchers continue to build up herds. On the whole, price supports for 1959 crops may not be much different than for 1958 crops, except notably for those cottongrowers who, under the provisions of the Agricultural Act of 1958, may elect some expansion in cotton acreage while at the same time a lower price support level.

Meanwhile, some further rise in farm costs is likely in 1959. The index of prices paid by farmers for commodities, interest, taxes, and wage rates rose 3 percent in 1958, continuing an uninterrupted rise since 1955. Over the past year, significant price increases have occurred for food and feeder livestock purchased by farmers and for motor vehicles and farm machinery, as well as for interest, taxes, and farm wage rates. Prices and cost rates paid by farmers may hold close to the current level but nevertheless the relationship between average prices received and average prices paid, which improved last year, may be less favorable in 1959.

In this matter of price trends in the nonfarm economy, we need also to look at chart 1 which shows the change in prices associated with the food market basket—that is, a fixed set of domestically produced farm food products representing average quantities purchased by urban worker families in a fairly recent year. Between the fourth quarter of 1957 and the fourth quarter of 1958, the retail cost of the market basket to the consumer increased some $34, or 3 percent, while at the same time the value of the raw products at the farm declined slightly. In the case of meat products which have been largely responsible for the rise in food prices, less than half of the increase at retail traces back to the farm.

Turning now to farm income (chart 2), the consensus last fall was that there may be a moderate reduction in farm operators' realized net income in 1959, perhaps on the order of 5 to 10 percent. This would come, of course, after a very substantial rise of some $2 billion, or 20 percent, in 1958, to the highest level in 5 years.

The increase in realized net income occurred despite a substantial rise in production expenses and came out of two main factors: The real improvement in the livestock markets and the record level of crop output which sharply increased the flow of commodities under loan to the Commodity Credit Corporation and thus Federal budget expenditures. For calendar 1959 we expect cash receipts from farm marketings (which includes farm receipts from CCC loans) to be much the same as in 1958.

Some reductions may occur in cash receipts from hogs and wheat if present production prospects materialize, but an increase in cotton acreage and receipts could also occur. On the other hand, the acreage reserve of the soil bank has been eliminated. This provided some $700 million in Government payments to farmers last year. Part of this reduction, however, will be offset by larger payments under the expanded conservation reserve. Farm production costs will almost certainly show some further rise. In total, a reduction of about $1 billion in realized net farm income seems likely at this time. But with the economy again moving up, the income of farm people from nonfarm sources may rise, thus easing the impact of somewhat lower income from farming.

At this point let me turn to farmers' expenditures in the important capital investment sector. There is little question that the increase in farm income and farm spending in 1958 made some positive contribution to the economy during the recession and subsequent recovery. Farm income was increasing at the same time that labor income was declining, and rural markets were strengthened accordingly. Production of tractors and other farm machinery showed gains at the same time that output in other heavy good sindustries was sharply reduced. Farm investment outlays for construction and farm machinery run annually at about $4 billion, or 7 percent of the total investment in the economy. For 1959 the income situation in agriculture does not appear to involve a significant change in farm investment outlays, keeping in mind the pressures for cost reductions in farm operations as well as the fact that farmers' depreciation allowances have grown to be about as large as their current investment level.

Finally, farm output will likely continue high in 1959. Total crop output rose 11 percent in 1958, with record yields established for most major crops. While this was partly the result of unusually favorable growing conditions, it also reflected the continuing gains in crop technology which have brought steady increases in yields in recent years. Yields may well average lower for some 1959 crops, and the first report on the 1959 winter wheat crop (as of December 1) indicates somewhat lower yields and a reduction of over 200 million bushels in the size of the crop from 1958. But the final outturn will depend largely on future weather developments. On the other side, some 17 million acres withdrawn from use in the acreage reserve last year is available for the 1959 season. As mentioned earlier, hog production is expanding, poultry producers entered the year with high production rates and a small increase in dairy production also seems probable in 1959.

This season our carryover stocks will show a substantial rise, particularly for wheat and feed grains (chart 3). Even so, we have a strong domestic market for most foods, which has continued to expand steadily in the past year, even during the recession period. Our exports, which involve substantial Government financed programs, are still high, although recently running slightly lower than a year ago, substantially a result of smaller exports of cotton. The Commodity Credit Corporation investment in commodities under loan and an inventories, according to the President's budget message, will likely rise from some $7 billion in mid-1958 to $9 billion in mid-1959.

Meanwhile, farmland values per acre continue to rise, averaging some 6 percent higher for the Nation as a whole between November 1957 and November 1958, again with increases in every State. Thus the farm balance sheet continues to show substantial increases in farmers' equities, despite a further increase (of about 5 percent) in farmers' commercial indebtedness (i.e., excluding commodity loans from CCC).

(The table and charts accompanying Mr. Wells statement follow:)

TABLE 1.—*Selected data relating to agriculture, United States, 1939, and 1946–59*

| Year | Index numbers 1910–14=100 | | Parity ratio (percent) | Farm output (index numbers 1947–49=100) | | | Food consumption per capita (1947–49=100) | Agricultural exports | Cash receipts from farm marketings [1] | Realized net income of farm operators [1] [2] | Total farm debt Jan. 1 (excluding CCC) [4] | Index farm-land values per acre Mar. 1 (1912–14=100) | Food market basket [3] | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Prices received by farmers | Prices paid or parity index | | Total | Livestock and products | Crops | | | | | | | Farm value | Farm-retail spread |
| | | | | | | | | *Millions* | *Millions* | *Millions* | *Billions* | | | |
| 1939 | 95 | 123 | 77 | 80 | 85 | 82 | 94 | $655 | $7,872 | $4,394 | [5] $10.0 | $82 | [3] $172 | [3] $279 |
| 1946 | 236 | 208 | 113 | 98 | 101 | 98 | 104 | 3,173 | 24,802 | 15,223 | 7.7 | 141 | (3) | (3) |
| 1947 | 276 | 240 | 115 | 95 | 100 | 93 | 102 | 3,957 | 29,620 | 17,304 | 8.4 | 157 | 467 | 444 |
| 1948 | 287 | 260 | 110 | 104 | 97 | 106 | 99 | 3,472 | 30,227 | 16,057 | 9.2 | 170 | 497 | 485 |
| 1949 | 250 | 251 | 100 | 101 | 103 | 101 | 99 | 3,578 | 27,828 | 13,789 | 10.2 | 177 | 435 | 493 |
| 1950 | 258 | 256 | 101 | 100 | 107 | 97 | 100 | 2,873 | 28,512 | 13,185 | 10.8 | 174 | 432 | 488 |
| 1951 | 302 | 282 | 107 | 103 | 112 | 99 | 98 | 4,040 | 32,958 | 15,158 | 12.3 | 200 | 497 | 527 |
| 1952 | 288 | 287 | 100 | 107 | 112 | 103 | 100 | 3,431 | 32,632 | 14,416 | 14.0 | 221 | 482 | 552 |
| 1953 | 258 | 279 | 92 | 108 | 114 | 103 | 101 | 2,847 | 31,126 | 13,899 | 14.9 | 221 | 445 | 558 |
| 1954 | 249 | 281 | 89 | 108 | 117 | 101 | 101 | 3,054 | 29,953 | 12,201 | 14.7 | 216 | 421 | 565 |
| 1955 | 236 | 281 | 84 | 112 | 120 | 105 | 102 | 3,199 | 29,556 | 11,470 | 15.6 | 224 | 395 | 574 |
| 1956 | 235 | 285 | 82 | 113 | 122 | 106 | 104 | 4,170 | 30,539 | 12,111 | 17.0 | 232 | 390 | 582 |
| 1957 | 242 | 295 | 82 | 113 | 121 | 106 | 102 | 4,505 | 29,757 | 10,840 | 17.9 | 247 | 401 | 606 |
| 1958 | 255 | 305 | 84 | [6] 123 | [6] 124 | [6] 118 | 101 | 3,875 | 32,900 | 13,000 | 19.2 | 262 | 427 | 638 |
| 1959 | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- | [7] 20.3 | ---- | ---- | ---- |
| 1957: | | | | | | | | | *Billions* | *Billions* | | | | |
| 3d quarter | 246 | 295 | 83 | ---- | ---- | ---- | ---- | 962 | 29.6 | 10.9 | ---- | [8] 253 | 415 | 615 |
| 4th quarter | 242 | 298 | 81 | ---- | ---- | ---- | ---- | 1,128 | 29.7 | 10.7 | ---- | [9] 258 | 408 | 607 |
| 1958: | | | | | | | | | | | | | | |
| 1st quarter | 254 | 302 | 84 | ---- | ---- | ---- | ---- | 924 | [7] 32.4 | [7] 12.8 | ---- | [10] 262 | 436 | 620 |
| 2d quarter | 261 | 306 | 85 | ---- | ---- | ---- | ---- | 988 | [7] 33.3 | [7] 13.6 | ---- | ---- | 444 | 641 |
| 3d quarter | 254 | 305 | 84 | ---- | ---- | ---- | ---- | 906 | [7] 33.0 | [7] 12.9 | ---- | [8] 268 | 420 | 648 |
| 4th quarter | 250 | 308 | 81 | ---- | ---- | ---- | ---- | 1,057 | [7] 33.1 | [7] 12.6 | ---- | [9] 274 | 406 | 643 |

Compiled from Agricultural Marketing Service, Agricultural Research Service, and Foreign Agricultural Service data.

[1] Quarterly data are seasonally adjusted annual rates.

[2] Note this is net income of farm operators from farming. Net income to all persons on farms, including hired farm labor, from both farm and nonfarm sources, is a different series, estimated at $7,689 million for 1939 and $20,244 million for 1957.

[3] The market basket includes estimated quantities of farm food products purchased per urban wage-earner and clerical-worker family in 1952. Data for 1939 based on same market basket as 1947 to date. Comparable data for 1946 not available.

[4] Total farm debt excluding debt on nonrecourse loans to the Commodity Credit Corporation.

[5] As of Dec. 31.

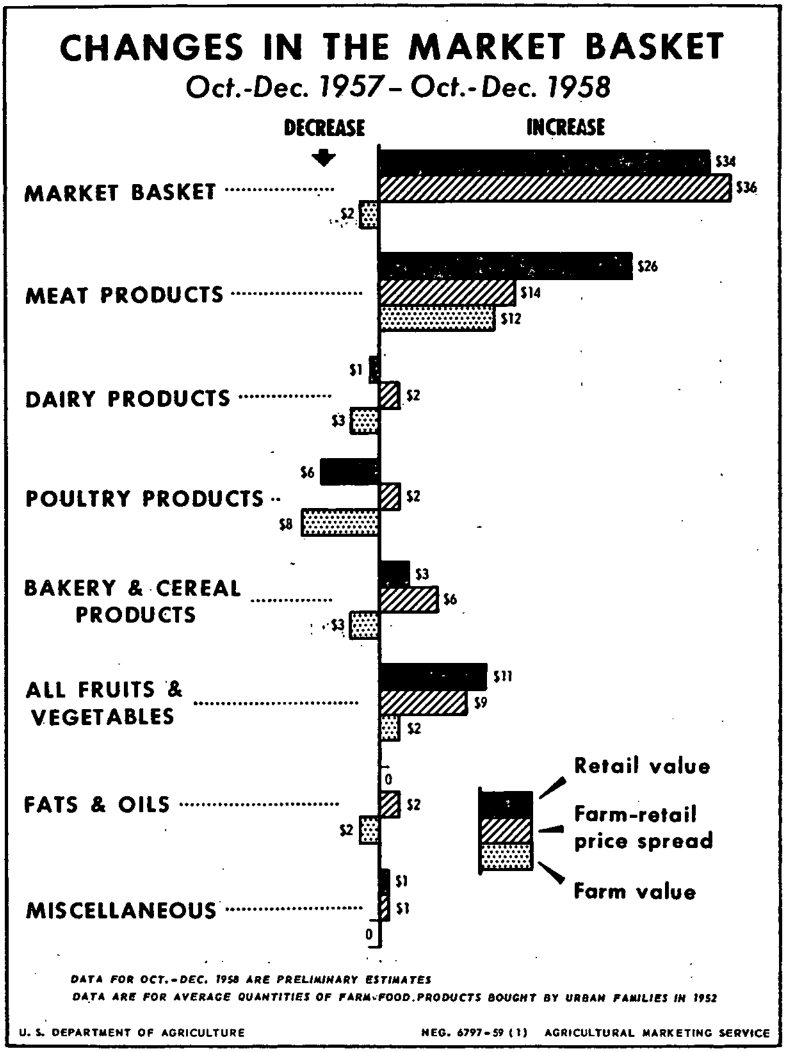
[6] Based largely on December 1958 Annual Summary, "Crop Production Report."

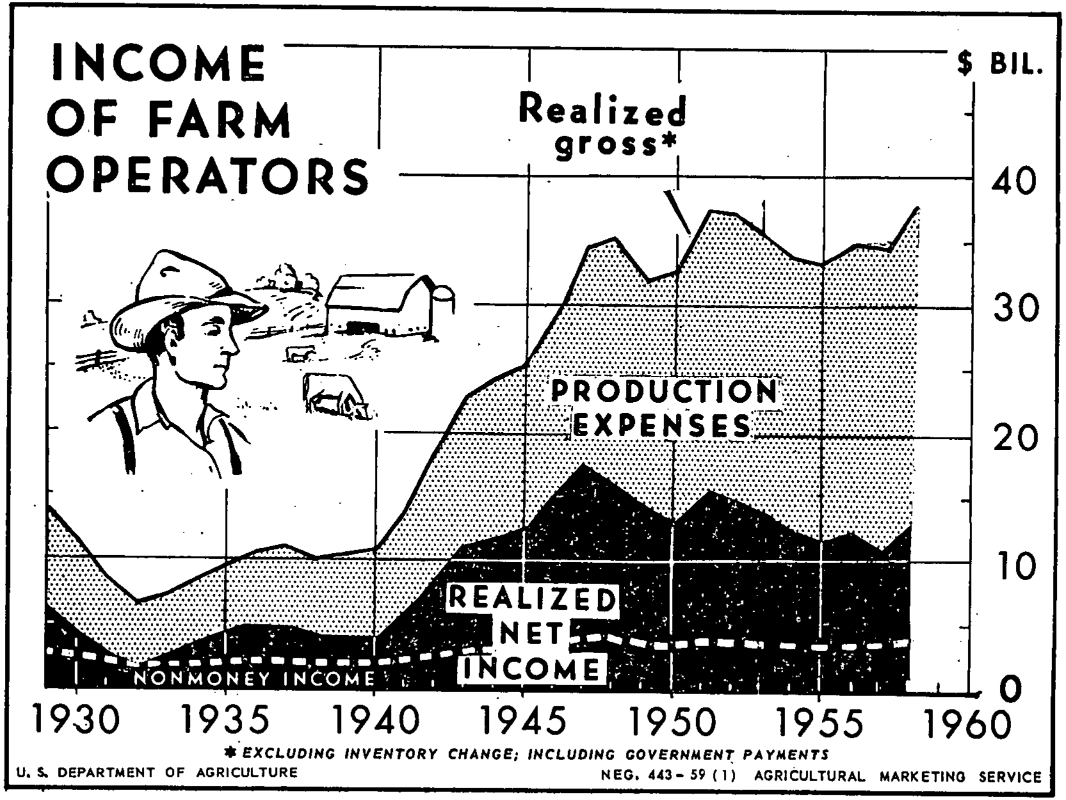
[7] Preliminary.

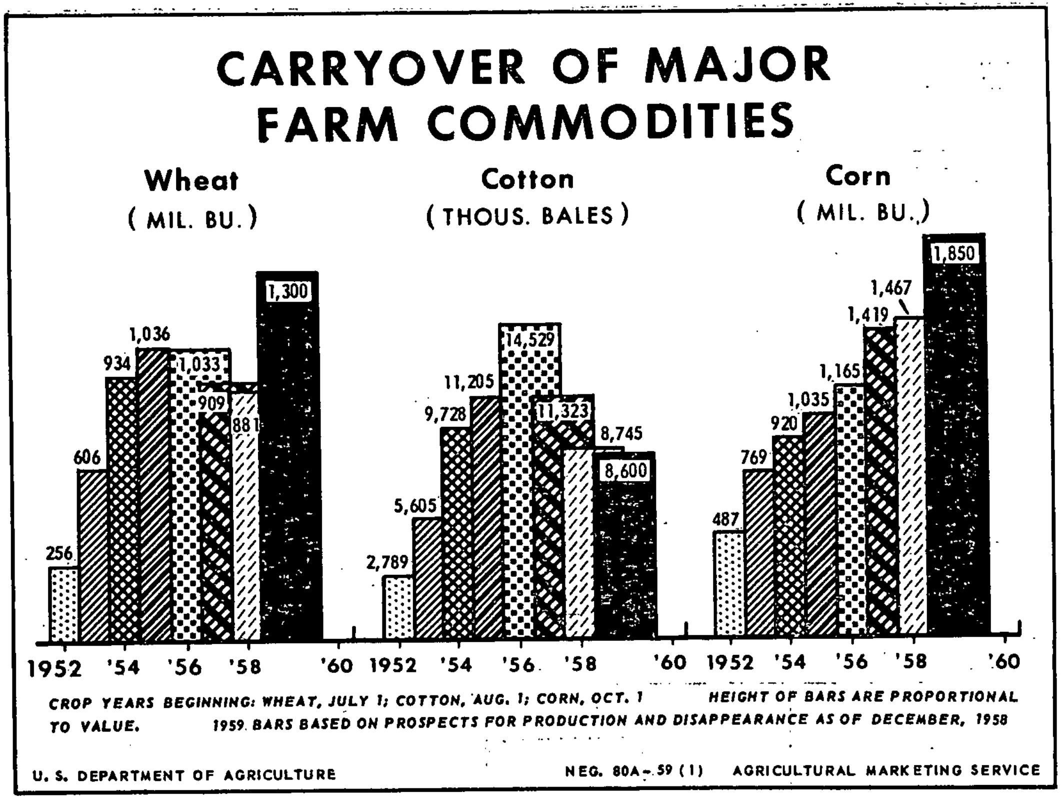
[8] July 1.

[9] Nov. 1.

[10] Mar. 1.


CHANGES IN THE MARKET BASKET
Oct.-Dec. 1957 – Oct.-Dec. 1958
DECREASE
INCREASE
MARKET BASKET
$34
$36
$2
MEAT PRODUCTS
$26
$14
$12
DAIRY PRODUCTS
$1
$2
$3
POULTRY PRODUCTS
$6
$2
$8
BAKERY & CEREAL PRODUCTS
$3
$6
$3
ALL FRUITS & VEGETABLES
$11
$9
$2
FATS & OILS
0
$2
$2
MISCELLANEOUS
$1
$1
0
Retail value
Farm-retail price spread
Farm value
DATA FOR OCT.-DEC. 1958 ARE PRELIMINARY ESTIMATES
DATA ARE FOR AVERAGE QUANTITIES OF FARM-FOOD PRODUCTS BOUGHT BY URBAN FAMILIES IN 1952
U. S. DEPARTMENT OF AGRICULTURE
NEG. 6797-59 (1) AGRICULTURAL MARKETING SERVICE


INCOME OF FARM OPERATORS
$ BIL.
Realized gross*
PRODUCTION EXPENSES
REALIZED NET INCOME
NONMONEY INCOME
0
10
20
30
40
1930
1935
1940
1945
1950
1955
1960
* EXCLUDING INVENTORY CHANGE; INCLUDING GOVERNMENT PAYMENTS
U. S. DEPARTMENT OF AGRICULTURE
NEG. 443-59 (1) AGRICULTURAL MARKETING SERVICE


CARRYOVER OF MAJOR FARM COMMODITIES
Wheat
( MIL. BU. )
Cotton
( THOUS. BALES )
Corn
( MIL. BU. )
256
606
934
1,036
1,033
909
881
1,300
2,789
5,605
9,728
11,205
14,529
11,323
8,745
8,600
487
769
920
1,035
1,165
1,419
1,467
1,850
1952 '54 '56 '58 '60
1952 '54 '56 '58 '60
1952 '54 '56 '58 '60
CROP YEARS BEGINNING: WHEAT, JULY 1; COTTON, AUG. 1; CORN, OCT. 1 HEIGHT OF BARS ARE PROPORTIONAL TO VALUE. 1959 BARS BASED ON PROSPECTS FOR PRODUCTION AND DISAPPEARANCE AS OF DECEMBER, 1958
U. S. DEPARTMENT OF AGRICULTURE
NEG. 80A-59 (1)
AGRICULTURAL MARKETING SERVICE

The CHAIRMAN. Thank you, Mr. Wells.
Mr. Bean.

## STATEMENT OF LOUIS H. BEAN, CONSULTING ECONOMIST

Mr. BEAN. I wish to draw attention to several facts that bear on (1) the outlook for agricultural prices for the next 2 or 3 years, (2) the relation of agricultural prices to general price stability, (3) the relation of general price stability to the Federal budget and to longtime economic growth.

The prospect for farm prices is for a further decline of as much as 12½ percent.

This is a 2-year point of view rather than the 1-year point of view which Mr. Wells just gave you.

This will continue to offset the rising level of other items in the cost of living and help to keep the general level of prices relatively stable. Contrary to current belief, recent experience indicates that when Federal expenditures exceed receipts the general price level was relatively stable but in the years when receipts exceeded expenditures the general price level advanced. Also contrary to common belief, experience shows that economic growth does not necessarily depend on a stable price level, for we have had economic growth with a gradually falling, rising, or stable price level.

The agricultural price level is normally much more volatile than the nonagricultural and therefore calls for special attention before this committee. Since World War I, farm prices have experienced six cyclical declines from monthly highs to monthly lows, as follows, each in varying degrees associated with agricultural surpluses.

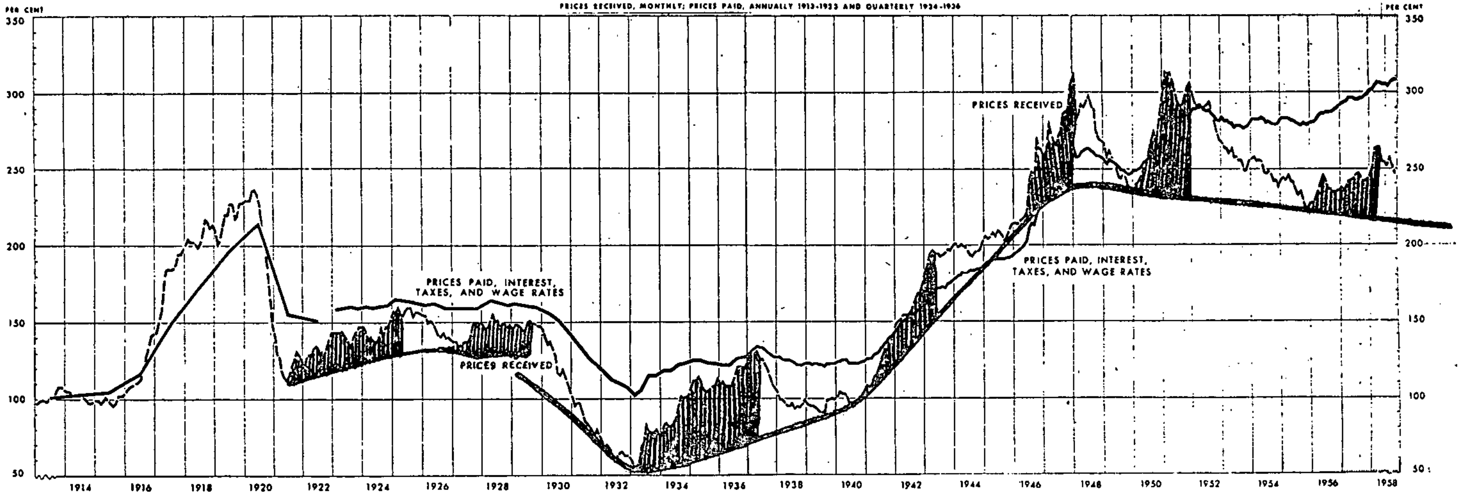
| | *Percent* |
|---|---|
| 1. 1920–21 | 53 |
| 2. 1925–27 | 16 |
| 3. 1929–33 | 59 |
| 4. 1937–39 | 32 |
| 5. 1948–50 | 24 |
| 6. 1951–55 | 29 |
| 6-period average | 34 |
| 4-period average (excluding 1 and 3) | 25 |

I hope there has been distributed to you a chart which I have borrowed from the Federal Reserve Board and had shaded in to emphasize these periods, or the rising phases of these several periods, and to give you an impression of inevitability of a decline that is likely to follow the recent rise in the level of farm prices to the peak of the spring of 1958.

PRICES PAID AND RECEIVED BY FARMERS

DEPARTMENT OF AGRICULTURE DATA, 1910-1914=100

PRICES RECEIVED, MONTHLY; PRICES PAID, ANNUALLY 1913-1923 AND QUARTERLY 1924-1936



The average of the six declines amounts to 34 percent and leaving out the 1920–21 and 1929–33 extremes, the average is about 25 percent.

Since the peak reached in April–May 1958, there has been a decline of 7 percent and there could, therefore, be an additional decline of about four times as much during the next 2 to 3 years before another cyclical upswing sets in. The impending danger is that the level of farm prices which stood at 264 percent (1910–14=100) in April–May of 1958 and 246 in December might continue down to a level of 210, at which point the ratio to the parity price index, now at 80, would be down to 70 or lower.

This widening spread between farm and industrial prices reflects chiefly the mounting volume of stocks. The record of January 1 stocks of all farm products in all positions since 1944 and the December–January parity price ratio is as follows:

| | Total stocks of farm products, Jan. 1 (1947–49 equal 100) | Parity price ratio, December to January average (1910–14 equals 100) | | Total stocks of farm products, Jan. 1 (1947–49 equal 100) | Parity price ratio, December to January average (1910–14 equals 100) |
|---|---|---|---|---|---|
| 1944 | 105 | 113 | 1952 | 110 | 105 |
| 1945 | 106 | 110 | 1953 | 118 | 95 |
| 1946 | 101 | 110 | 1954 | 129 | 91 |
| 1947 | 98 | 115 | 1955 | 138 | 86 |
| 1948 | 92 | 119 | 1956 | 148 | 81 |
| 1949 | 111 | 104 | 1957 | 151 | 82 |
| 1950 | 118 | 95 | 1958 | 151 | 82 |
| 1951 | 117 | 110 | 1959 | (155) | 80 |

Mr. BEAN. If you study this particular table in relation to the chart that I have just given you, you will see the main reason for the ups and downs in the level of farm prices for these cyclical movements.

Weather and technology, not price supports, are chiefly responsible for these surpluses. Weather will again in 1959 provide yields per acre close to those of 1958.

Since it is practically certain that stocks will be higher on January 1, 1960, than at present, it would not be surprising to see the parity ratio fall below 80 and farm income continue its 1959 decline into 1960, especially if, in the face of mounting surpluses, official policy continues mistakenly and inconsistently to call for more freedom for farmers to produce more and to compete at lower prices.

So far the price support programs have prevented the mounting surpluses from having their full impact on farm prices and income. Taking population growth into account, the accumulation of stocks by the CCC has prevented the parity price ratio from going to 70 or lower and has supported 1958 farm income to the extent of $4 billion or more.

The decline in farm prices which has served to offset the rise in industrial prices and the addition of $4 billion to farm purchasing power through CCC operations need to be recognized as contributing to stability in the general price level and to the economy as a whole.

A review of general price movements over the past 6 years as well as over the past 100 years raises questions as to whether we know as much as we should about the relation of a balanced Federal budget to prices and of prices to economic growth. Contrary to the views commonly expressed, a balanced budget does not necessarily mean price stability, nor does a Federal deficit in peacetime mean price advances. If you compare charts 6 and 16 of the 1959 Economic Report of the President, you will find that prices in general advanced in the 3 years of Federal surplus, 1955, 1956, 1957, and remained relatively stable in the 3 years of Federal deficits, 1953, 1954, and 1958.

Similarly, we need a closer analysis than has been presented so far of the dependence of a vigorous, long-time rate of growth on so-called price stability. Since 1860 we have had three periods of stable economic expansion, excluding war and major depression periods, namely, 1882–92, 1902–12, 1923–29, and 1948–57. In the first period, industrial production advanced 6.1 percent per year (straight average) in the face of a 1.3 percent per year decline in the cost of living. In the second period, industrial production expanded at a rate of 5.1 percent but living costs advanced 2.1 percent per year. In the third period, 1923–29, industrial production advanced 4.2 percent per year with living costs remaining practically unchanged. In the latest period, 1948–57, production again expanded at a rate of 4.2 percent per year and the cost of living advanced 1.9 percent per year.

This record suggest that it is not necessary for officials or other circles to welcome or promote the impending decline in farm prices in order to assure economic growth. Economic growth apparently depends a great deal more on factors other than a stable, rising, or declining index of living costs.

The CHAIRMAN. Thank you very much, Mr. Bean.

That concludes the presentation of opening statements by the participants.

Procedure in past years has been to have members of the panel raise questions with each other if they wish and then for members of the committee to ask questions of the panel.

Do members of the panel wish to discuss issues with each other? I notice a very sharp difference of opinion between Mr. Wells and Mr. Bean. I wonder if they want to thresh out their differences publicly.

Mr. WELLS. Well, Mr. Chairman, all I would say is that Mr. Bean has expressed a number of ideas concerning the balance or imbalance of the Federal budget, the shape of the business cycle and finally the probable decline in farm prices. I find him more pessimistic than I am. I think what he is saying is that he agrees some things are going to happen in the years immediately ahead which may bring farm prices down.

His main emphasis is on 1960. I should be very much surprised if the farm prices went to a level of 210 in 1960.

The CHAIRMAN. Mr. Bean.

Mr. BEAN. I would like to amplify the reasons for suggesting a greater decline in prices than seems to be embraced either in the expectations of the President's report or Mr. Wells' statement.

If you dig into the items in the agricultural situation more deeply, you will see these rather important developments. It is admitted in general that the stocks in the hands of the CCC will continue to mount. They will be higher next January than they were last January. The President's report indicates that in the summer of 1960 they will be higher than in the summer of 1959.

That fact alone, if you would relate it to the earlier movements of the price index, you will find calls for a decline in farm prices.

Second, if you study the reasons for the high level of production and stocks and attempt to anticipate the effects of these factors for the next year or two, here is what I seem to see.

We have had a high yield per acre of cotton. In spite of that fact, the statistics of yields as I study them point to a still higher yield per acre in 1959. The Department of Agriculture now estimates that the 1959 winter wheat crop will be about 200 million bushels below that of last year, which was an unusual record high. The record of yields per acre in winter wheat shows a very strong tendency for the December estimate—which was just released, as foreshadowing the crop of 1959—to be lower than the actual results.

Therefore so that the reduction of about 200 million bushels as now estimated may be an overstatement. So, in terms of the wheat production situation in 1959, I see, as in the case of cotton, a large crop, fully as large or nearly as large as that of 1958.

In the case of the feed crops, which are the large element in the rising stocks, you find that an unusual sharp trend in yields has developed in the last 5 or 10 years. And that basic uptrend will probably offset any reduction in yields that weather itself might produce in 1959. When you add these things up, you are forced to the conclusion that the level of stocks, in the summer of 1960 will be higher, substantially higher than at present; and if the relationship that we have had in the past two decades or more between these stock figures and the movements of agricultural prices means anything, then I think you should expect this level of farm prices to continue moving downward for a period of about 2 years, possibly reaching a level of 210 before the decline ceases.

The CHAIRMAN. Mr. Wells, do you have any comments?

Mr. WELLS. We do probably have some further increases to stocks ahead. I can't go nearly so far as Mr. Bean does. We also have to look at what is happening in the rest of the American economy.

We have just finished a year in which Mr. Clague indicates that, despite recession and unemployment, the round of wage increases so far as we know statistically was almost identical with the preceding year. We have an outlook for this year which will lead me to believe that 1959 and probably 1960 will also be fairly good business years. And I can't quite see us turning loose of the farm situation where we go to the level that Mr. Bean has suggested.

The CHAIRMAN. Of course, it is true, is it not, that the elasticity of demand for farm products is very appreciably less than unity, with incomes constant; and that the income elasticity of demand for farm products is also appreciably less than unity. Isn't that true? So that an increase in farm stocks will have a very depressing influence on unit price, and a rise in average incomes will not have a corresponding stimulating effect upon quantities demanded. Isn't that true?

Mr. WELLS. Yes.

But we expect consumer incomes to go up. And the major portion of farmers' incomes is from the sale of livestock, fruits, and vegetables, not from the price-supported crops, which are most of the crops Mr. Bean referred to. When you go into the price-supported crops where we have had the large increases recently, prices are inelastic only until they fall to the support level. The 1,400 million bushel wheat crop last year, for example, didn't carry prices much under the support level—prices were simply a level line because the

Commodity Credit Corporation picked up the surplus. You have to look at what you expect Government to do.

You have also to look at what is happening in the rest of the economy. It looks for 1959 from the standpoint of livestock, from the standpoint of fruits, from the standpoint of vegetables, from the standpoint of food consumption, that the picture is fairly good. From the standpoint of probable yields and stocks of the surplus crops, there are some real difficulties. I am perfectly frank to admit this.

The CHAIRMAN. Are there any other issues that the members of the panel wish to raise with each other?

Mr. BEAN. Just one footnote to Mr. Wells' remarks.

One point not covered so far in his statement is that recent farm legislation automatically provides for a further whittling down of the level of supports.

And also when you do have large surpluses in commodities that are supported, commodities that do not all go to the CCC do have a depressing effect on price, especially in such commodities as corn and other feed crops.

It is not unusual to see the actual farm price level substantially below the support level.

The CHAIRMAN. Any other comments?

Mr. FRIEND. Bill Butler has presented some estimates which add up to a very optimistic projection of the year ahead. I presented some which I would classify as moderately optimistic. I was wondering whether any other members of the panel had projections which were definitely more pessimistic?

I won't ask for any more optimistic estimates.

Mr. PARADISO. Well, one of the things I don't see is this very sharp rise which is assumed by Mr. Butler and Mr. Gainsbrugh.

The CHAIRMAN. That is, you do not see it.

Mr. PARADISO. I do not see a sharp rise in the plant and equipment expenditure pattern, as is reflected in the new order picture received by the durable equipment industries. These new orders have not shown any perceptible upturn. There is a considerable lag between the receipt of such orders and actual outlays.

The CHAIRMAN. Well, we will open the discussion with Congressman Curtis.

Representative CURTIS. I wanted to get back to the subject of labor statistics, Mr. Clague, and to try to estimate what would be an "acceptable" level of unemployment. The reason I raise it is that there seemed to have been a higher level, using the term as relative, of unemployment after the 1954 recession and it was from this somewhat higher level that the present recession started.

I am wondering whether or not that really is a high level or is it, to a large degree, a result of the changing character of our population. Perhaps we have more people in the older age brackets who possibly think they are in the labor market but are not very energetically so.

Is there any other explanation that you might suggest as to why this seemingly high level of unemployment persisted after 1954?

Or do you think that in this prospective period of prosperity in 1959–60, that we may expect to go below that level?

Mr. CLAGUE. Mr. Curtis, I think your statement is basically correct. If I may change it around a little bit.

Representative CURTIS. Yes.

Mr. CLAGUE. Our figures seem to show that when you have a period of business recession, particularly after it has lasted for awhile, a number of these marginal workers do withdraw from the labor market.

They probably can't find jobs. Some of them go on old-age insurance or on private pensions. There has been a sharp rise in old-age insurance payments during the last year. They withdraw then from the labor market and are not active in seeking jobs.

Likewise, there are the women and the young children in school or youngsters who might quit school and go to work—they don't do so in a period of recession.

Now, as our business conditions and production expand, those people come back in. They did come back in, as you will notice in 1955 and 1956. And we got above our normal trend line increase, as we showed in chart 1.

In the last 2 years, they have been less present there.

Now, I am guessing at present—or we are guessing—that perhaps they may come back in the prosperity of 1959 and 1960.

Representative CURTIS. But the point I am getting at is this: During the so-called prosperous years of 1955, 1956, and 1957, we still kept that relatively high percentage of unemployed in relation to what had gone before, so that we had this high level relatively level, when we started into the 1957–58 recession. The question I have in mind is: Is that higher level something that is likely to prove more normal for the future? Possibly a new level of "normality" might arise from the changing composition of our population. Can we anticipate in 1959 and 1960 that our unemployment figures will still remain around 4 percent, perhaps?

Mr. CLAGUE. The question is what is a normal level of, say, prosperity unemployment? Could we call it that? About which you get even in the most prosperous times.

Well, in the years following World War II we got down to as low as 3 percent unemployment, which is about 2 million, on a labor force of over 60 million, only in the Korea years—1951–53.

This was natural during a semiwar period. Now, more recently it rose to over 4 percent in 1955 and 1956 and the early part of 1957. Of course, the absolute figures look a little larger because our labor force has moved up in the meantime also. We have now a labor force of about 71 million. So 4 percent is about 3 million. So in looking at the figures back over the years, the absolute figures over the years, you should bear in mind that a same fraction would give you a somewhat larger figure.

Representative CURTIS. What you are saying is that you think possibly 4 percent is today a more normal figure, and possibly, therefore, an acceptable level of unemployment rather than 3 percent?

I am trying to find out where we might draw a line of what we could regard as an acceptable level of unemployment, if there is such a thing.

Mr. CLAGUE. Well, let us say, to get below 4 percent you are getting into very full production and very full prosperity.

Let's say that is something below 3 million.

I might emphasize there is a lot of turnover occurring at that time; industries rising, industries declining.

One factor that doesn't show up in the quoted figure of unemployment is how many of them have been out of work how long.

In fact I cite in my testimony here some figures from the spring of 1958 which was what we might say quite a recession period. There still were a surprising number of people who went into jobs, a surprising number that came out of jobs again. If you don't have any long-run unemployment, if the workers are turning over and are covered by unemployment benefits, I would say in a progressive economy like ours, with as much change as is occurring in our economy, you have to have a very high level of prosperity to get below 4 percent unemployment at any one time.

Representative CURTIS. I wonder if any of the panel would care to discuss that because I think it is a very important point, particularly to this committee.

Mr. NEWCOMB. I would like to raise one point. You have a chart here which to me is very significant showing the production and nonproduction workers in manufacturing.

Mr. CLAGUE. Yes.

Mr. NEWCOMB. Production workers come to a little under 25 percent of the total. The nonproduction workers dropped over a million from the peak of 1955 to the peak of 1957. They dropped another million almost. They are down below 12 million now.

Now, if you would calculate productivity in terms of production workers rather than in terms of total workers in factories, would you not have had an increase in 1958?

Is this true?

That what happened in 1958 in part was we added to our nonproductive workers research and development, which was mentioned here a minute ago. That sort of thing tends to conceal what is going on in the plant itself and therefore may make a drop in the unemployment a little more difficult—because productivity did continue to rise in 1958 and therefore won't rise as much among the production workers in 1959, as it would otherwise have been possible.

The CHAIRMAN. I think you perhaps inverted the terms. What you are saying is that the number of so-called productive workers dropped, but the number of nonproductive workers remained relatively constant or went up? And, therefore, the productivity of men out on the factory floor rose much more than the overall average for the industry?

Isn't that what you are saying?

Mr. NEWCOMB. Yes. And that has implications for the future.

Mr. CLAGUE. Yes. Mr. Newcomb is correct. I want to emphasize one point: the productivity data that we are furnishing this committee includes both types. You have got to include all of the labor that is involved in the production.

Surely research and development, more engineers, more machinists to repair machines and so forth, that is what the gains in technology consist of. Of course, they consist in eliminating unskilled or semiskilled labor or repetitive labor which shows up in the so-called production workers.

This trend has been going on for some time. And, of course, another trend which is shown in one of my other charts here is the shift from manufacturing of goods generally to the production of services. As you will see on that chart, total employment in the production of goods, which is farming and manufacturing and mining and construction all combined, has not grown in 40 years.

The employment has grown in the service industries and in the other types of industries.

Representative CURTIS. I wonder if I could get back to my question. Possibly Mr. Friend commented somewhat in his paper on this area of whether or not the phenomenon of 4 percent unemployment might be an acceptable figure. I don't know.

Mr. FRIEND. Let me say first of all that apparently we both agree that 6 percent is not tenable. Four percent gets to be closer to the margin of controversy.

And I would say that I would greatly prefer 3 percent to 4 percent if you could get this without too great a cost in terms of too rapidly rising prices and in terms of controls that you might have to institute to prevent prices from rising too rapidly. Our objective should be clearly—I guess everyone would agree on this—to keep the residual level of unemployment at the lowest possible point.

Representative CURTIS. Let me ask this to be sure to bring this out: Do you believe that the composition of our society in age groups would make a difference in what would be the acceptable figure of unemployment, percentage figure?

I have a feeling that as our population proportionately grows older—and that will stop sometimes—the acceptable figure of unemployment would increase. Would you comment on that observation?

Mr. FRIEND. I would not be able to refer to any data in this connection. My impression is that it would not make much of a difference. This may not be a sound observation since I have no more evidence on which to base my opinion than anyone else would have. But I do not see offhand why it should make a difference. Because, as these people get sufficiently old, they leave the labor force and do not enter the unemployment figures. But if they want jobs, unless there is a very good reason why they should not have them, presumably they should be counted as part of the labor force.

Representative CURTIS. Your presumption is that they leave the labor force. Of course, some of them do actually leave the labor force, but there seems to be an inclination for some of them to continue to regard themselves as in the labor force; this gets back to the validity of our statistics.

Mr. FRIEND. You may be right. I have just the reverse impression. At least, there have been many comments in the papers this past year about the fact that it is the youngest group in the population that had been particularly affected by layoffs and that the older workers, as well as the middle group, had fared better.

Representative CURTIS. My time has expired.

The CHAIRMAN. Mr. Kilburn.

Representative KILBURN. Along that point, there is a growing tendency among a great many companies to have a retirement at 65. Does that affect it any?

Mr. FRIEND. I do not see how. If they do retire, they are out of the labor force. I suppose it is conceivable that they would retire from a company, receive a pension, and then consider themselves as remaining in the labor force. But again I have no evidence on that.

The CHAIRMAN. Congressman Reuss.

Representative REUSS. Mr. Chairman, I would like to ask the panel its view of the economic outlook for 1959 in terms of the three objectives of the Employment Act of 1946, which you will recall, are maximum employment, maximum production, and maximum purchasing power. Let's take the first one. May I have a show of hands or some other expression from those members of the panel who feel that the goal of maximum employment will be achieved in 1959?

Mr. BUTLER. It is my feeling that we will reach this goal by the end of the year or early 1960. But the year as a whole would not be characterized by that.

Representative REUSS. Let me ask whether the year will be characterized by maximum production? Does anyone feel that it will?

Mr. NEWCOMB. Could I ask him to define it? Do you mean a maximum feasible rate of expansion toward maximum employment or production?

Representative REUSS. My question was whether the average economic performance of the year 1959 will be characterized by maximum production. If you feel that we might get there toward the end of the year, please say so, and your opinion will be so recorded.

Mr. PARADISO. Do you mean close to productive capacity?

Representative REUSS. Yes.

Mr. NEWCOMB. I think all of us would agree we won't be there, but we will be rising at a healthy rate during the year. If we rose faster than most of us feel, it might generate strains that would be unfortunate. I think we are growing nicely. We will not reach maximum before the end of the year and maybe early spring.

Representative REUSS. Let me ask about the statutory goal of maximum purchasing power, which, of course, means maximum dollar stability—a minimum of inflation.

How many of you think that that will be a characteristic of 1959?

Representative REUSS. I see five hands.

Well, let's put it the other way. Who does not think that maximum purchasing power will be a characteristic of 1959?

Mr. FRIEND. I am sorry, I misunderstood the question.

Representative REUSS. You think that there will be inflation in 1959?

Mr. FRIEND. No; that is how I originally construed your question. Are you talking about prices now, or purchasing power?

Representative REUSS. I am talking about maximum purchasing power which is a statutory goal of the Employment Act, which has also been interpreted as meaning relative price stability.

Mr. FRIEND. I expect there will be relative price stability. But I think you will not have maximum purchasing power.

Representative REUSS. I suppose the phrase "maximum purchasing power" comprehends both price stability and maximum total income. I was referring to the former, maximum price stability—maximum absence of inflation—in my question.

And am I right in thinking that you all believe that there will be maximum price stability in 1959? I see no one dissenting.

The CHAIRMAN. Except Mr. Bean.

Mr. BEAN. On one condition. And that is that the Federal budget remain unbalanced. If you look at the record as shown in the President's report of the periods when the budget was balanced and when it was out of balance, you will find that during the 3 years of 1955, 1956, and 1957 when the budgets showed a surplus, we had rising prices. But in the other 3 years of 1953, 1954, and 1958, when the budget showed a deficit, you had price stability.

Representative REUSS. Then the entire panel, save one, agrees there will be maximum price stability. Mr. Bean says there will be maximum price stability if the budget stays unbalanced. Since I have a hunch that the budget will be unbalanced——

Mr. BEAN. Then you should expect price stability. May I ask a question here?

The CHAIRMAN. Yes.

Mr. BEAN. I find it difficult to respond to these questions, because I do not know the quantity standards that you may have in your mind when you use these phrases of "maximum employment" and "maximum purchasing power" and "maximum production." It seems to me that this committee and the Council have not as yet developed these three basic sets of figures. When you ask about will production be adequate to sustain a level of unemployment of only 3 percent, or whatever goes with maximum employment we need to know the production figure you have in mind.

Is it a Federal Reserve Board index you are asking for? In that case it should be 160, for full employment (now 142) especially after it is revised upward.

With regard to purchasing power, I am not sure that purchasing power really refers to the price level, a stable price level. I think it means the amount of money in the hands of consumers which will enable them to buy this volume of production which will support a 97 percent level of employment. And until the Council or this committee has in hand these three basic simple standards for 1959 and later years it will be difficult to answer this kind of question.

Representative REUSS. In asking about the possibility for achieving maximum purchasing power, I was interested in your forecast of relative price stability. As for maximum employment, let's say that this requires putting a very substantial dent in the present unemployment figure of 4,100,000—that you reach maximum employment when unemployment is reduced to 2,000,000 or 1,500,000. However, fine distinction appears unnecessary in the light of the general opinion that no very deep dent is going to be made in unemployment this year.

As to maximum production, I had in mind a much higher utilization of the industrial capacity which the Economic Report states is available this year. We appear to be using less than three-fourths of our capacity at present. The question is whether you gentlemen think we will come appreciably closer to a hundred percent utilization during the course of the year.

I do not know whether anyone wants to change his vote, but he is certainly free to do so.

Mr. BEAN. I think you will get greater unanimity if the time you ask about is not 1959, but say a year from now when most of the recovery will have taken place. If you make it the fiscal year 1959–60 rather than the calendar year 1959, I think you will get greater unanimity in our responses.

Representative REUSS. I thought there was quite a remarkable and, to me, surprising unanimity with respect to the calendar year 1959, the year which the Joint Economic Committee must consider. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Widnall.

Representative WIDNALL. Mr. Clague, are there any figures available in connection with the unemployment census to show the age groups?

Mr. CLAGUE. Oh, yes, there are figures on unemployment by age.

Representative WIDNALL. Has the more permanent unemployment been in the older age group? It has been said the younger age group is most affected by the drop in employment. Hasn't the most unemployment been in the old-age group?

Mr. CLAGUE. In general the picture is about like this: The older workers in industry generally, with their seniority and their status, become unemployed less often from industry than younger workers. The younger workers with less seniority are the ones that are dropped out first.

Now, as far as the older people are concerned, however, once they drop out, then they have a very hard time getting back in. A man of 55 is not readily reemployed by another firm. He may be called back by his own firm.

Now, one last word: As you will find in my paper here, the key long-term unemployed that you now have in the country today are mostly the middle-age workers who are in the hard goods manufacturing industries of steel, autos, et cetera, which are the industries that came down in this recession. This was a hard goods recession; it was a decline of the capital goods industries. And the long-term workers who are now drawing temporary unemployment compensation, for example, are heavily weighted with workers who are male, blue collar, production workers in the hard goods industries. So it is not either extreme of age that is so important right at the moment; it is a problem of the longrun experienced and permanent employees.

Now, as business recovery proceeds, and if reinvestment takes place, as Martin Gainsbrugh indicated, those people, of course, would get back into jobs in the industries to which they have been accustomed, namely, the heavy industries in this country.

Representative WIDNALL. Well, are there any figures that show out of, say, a figure of 5 million unemployed how many of those people are presently receiving retirement funds or pension funds or veterans' payments or security funds of one kind or another? In other words, they have income?

Mr. CLAGUE. Well, unemployment compensation is directly involved, of course. Because they would be entitled to unemployment compensation.

Representative WIDNALL. I mean apart from unemployment compensation.

Mr. CLAGUE. Well, perhaps I should explain that the unemployment figures are of two kinds. One is the figure collected by the Bureau of the Census which comes from families in their homes. That is a "self-voting" procedure. In that you ask the older person—or you ask everybody in the family "Are you at work? Are you looking for work?"

Well, this person "votes" according to how he feels about it. He might be drawing a pension from some concern and still say is is actively looking for work if he made even a casual inquiry about a part-time job. In other words, his own answers to carefully worded questions determine whether he really is unemployed. So he might get "voted" in.

Well, this person "votes" according to how he feels about it. He might be drawing a pension from some concern and still say he is actively looking for work if he made even a casual inquiry about a part-time job. So he might get "voted" in. In other words, his own answers to carefully worded questions determine whether he really is unemployed.

On the other hand, in most cases he will declare that he is retired now and he will not declare himself unemployed. And that gets to the point that Mr. Curtis was talking about.

Now, the factor of other kinds of payments: It is pretty hard to tell. Well, wait a minute; I want to cover the unemployed who are reported through the unemployment insurance system by the Bureau of Employment Security in the Department of Labor. All of those people are workers either entitled, or think they are entitled, to unemployment compensation benefits. So they have actively declared themselves for work.

They must register at an employment office to certify their intention to look for work. Consequently, all of those would be called unemployed unless you found some other way of eliminating some of them. So in answer to your question, we have both of these classes of workers classified by age groups.

But we cannot tell about the census figures as to whether the person—well, it is his own decision, in other words, as to whether he is seeking work or not.

The other system gives the employment office a chance to find out if he is really looking for work.

Representative WIDNALL. We are faced with a budget where we are going to have to make a lot of important decisions whether or not to hold the line, or whether in some areas we should increase or reduce.

I would like to toss this out to the panel. If there is additional Government spending with the idea of creating employment and a more healthy economy, where would it be most effective, in what field? If you had to pick out one field—housing, highways, etc.—in what field—or could you name three in order of your own belief with respect to where the best stimulus could be provided, where it would be most effective generally to the economy.

I think we are going to have to make some choices in these programs. And we appreciate any ideas you can give us along that line.

Mr. NEWCOMB. I think we can keep the volume of housing up if you want to pump money into it; it will react immediately. The house goes up. That means employment that day. Furniture is bought, and that means employment.

Here is a feasible method. I don't think you would have to use Federal money. You can allow FNMA to sell debentures in the markets or allow savings and loans to go to pension funds. There are devices of getting money flowing here. I suggested we have institutional blocks in the private money sectors which are interfering with growth. Maybe if Congress could do something about these institutional blocks we could get progress without using Federal funds.

But if you want to use Federal funds, here is a method:

Highways work just as fast. The highway has as high a ratio of capital goods to work done as a plant does. The huge machines on the highway cost a lot of money. When you give a contractor an order for a half a mile or a mile of road, he buys big machines. Employment generated works back to almost every State in the Union in a hurry.

I am suggesting this is true today. It would not have been true in the highway field 3 years ago. We are moving rapidly in the highway field now. The highway needs are there. The States are ready to let contracts. And if there is an increase in funds available, that could result in very quick employment and circulation of funds.

This is without reference to whether this should or should not be done.

Representative WIDNALL. Where do you think the greatest stimulus could be provided for employment and business throughout the economy and a healthy picture for all concerned?

Mr. NEWCOMB. I like both of those methods. They will work fast today and relatively easily.

Representative WIDNALL. Does any other member of the panel have a different approach?

Mr. PARADISO. I don't know that you can specify where the Government itself can pour money to help some of the segments that need stimulation of demand. Let me mention the three.

First, plant and equipment spending by business has not as yet turned around. What has happened is that the sharp decline has been stopped; but the spending actually has leveled off. It has leveled off at a pretty high rate. But if that spending were to increase substantially, the total economy would be rising much more rapidly.

This is one sector which cannot be affected directly, although it can be influenced indirectly as demands for goods and services increase. This would result in tightening up capacity and businessmen would add to that capacity and thus increase capitol spending.

Second, our net exports have been declining from something like $5 billion in 1957 to a couple of hundred million dollars in the fourth quarter of 1958, at annual rate.

Here again we may not be able to affect this area directly soon.

The third sector is consumer durable goods demand which was affected tremendously by a sharp decline in automobile sales. These sales have now perked up, but they are not phenomenal in any way.

I don't see how directly, through expenditure programs, the Government can make an impact on these three segments within a reasonable short period of time in the future. Indirectly, obviously, it can.

Mr. WELLS. Your question is a perfectly fair question and a most interesting one to economists who often talk about the "multiplier." The question of where you emphasize expenditures in any particular year has to depend on the situation that you are facing that year. It changes from time to time, even from month to month and from industry to industry. But in view of the performance which we expect of the private economy in 1959, my own personal first priority would be funds for research and development in those fields in which the Government is appropriately interested, especially if we are interested in a healthy economy not for the next few months but over the long run ahead.

Mr. FRIEND. I think in view of the type of projection that most members of the panel have made that this would not be the type of period, if in fact there is any period, when you would spend Government money basically to stimulate employment.

Now, if you did that in any period, it wouldn't be in the present period.

That is not to say that if there are any types of expenditures we want for other reasons, such as the national defense, we could not very well afford to have them now or any other time.

But I would think that Government expenditures which have as their main purpose income stimulation would not be called for at the present time.

Mr. BUTLER. I would like to agree with Mr. Friend. I think that we are experiencing a rate of recovery here which will bring us back to where we want to be by the end of the year or early next year. Growth in gross national product will be something on the order of 7 or possibly 8 percent, which is twice the long-term growth rate in the economy.

It seems that in this situation with some problems of inflation ahead, this is not the time for stimulants on the part of Government. And that if they were applied, the might complicate very importantly the problem of avoiding inflation in 1960.

Mr. FRIEND. I think that Bill Butler and I would both agree you can afford to increase any type of expenditure which you feel is urgently required for its own sake.

For example, defense.

Mr. NEWCOMB. I think housing is one area that may not grow under the financial institution.

The CHAIRMAN. I notice that each specialist, seems to feel the key to recovery lies in expansion.

Mr. BEAN. Mr. Chairman, there is on deviation to your statement. I would like to agree with Mr. Newcomb, even though my specialty is agriculture. I think if the question has to do with stimulating over the next 12 months not the long-term stimulation problem, then I would suggest that making certain that the housing program is maintained at a proper level will do a great deal to take up the slack in unemployment in the hard-goods industries, and including automobiles and will also stimulate the turnaround in capital expenditures.

The CHAIRMAN. I would like to have the privilege, if I may, of addressing some particular questions first and later perhaps one general question.

We have all held our breath so to speak as to what the news from Detroit would be on the new models in the autos. We have figures on production for the first 2 weeks that show a weekly average of around 134,000 as compared to a weekly average in the preceding January of 121,000, or a pickup of around 10 percent.

I think we all read the little news story in the New York Times either yesterday or the day before yesterday stating that Buick was laying off 2,000 men because sales had fallen off, and they wanted to adjust production to sales.

I wonder if anyone here has information on the most recent development of sales first, and then production of autos?

Mr. PARADISO. New car sales in December spurted quite considerably over November.

The CHAIRMAN. In December?

Mr. PARADISO. Yes, in December.

The CHAIRMAN. What about January?

Mr. PARADISO. In the first part of January, sales were somewhat above a year ago. But at that time you will recall sales were rather low.

The CHAIRMAN. That is right.

Mr. PARADISO. So, therefore, almost certainly as far as January is concerned, on a seasonably adjusted basis, sales are going to be somewhat below December. They don't at the present time give a conclusive indication of the market for 1959. I think this market is still to be tested. At the same time I would say as far as my personal judgment is concerned, they are not encouraging so far this year. Inventories have been accumulating very rapidly. And this is the reason, by the way, why Buick has cut some production.

The CHAIRMAN. I haven't seen the last issue of Wards Reports. But what are the figures on inventories now?

Of new cars and of used cars?

Mr. PARADISO. As I recall new car inventories held by dealers were about 580,000 at the end of last year.

And there has been a very sharp lift in this number so far this year.

The CHAIRMAN. You mean an increase.

Mr. PARADISO. Yes; from the total number of new cars held by dealers at the end of December of last year of around 580,000. This represents a rapid rise from something like 400,000 in November of last year.

Mr. BUTLER. That was the end of the year—the 580,000.

Mr. PARADISO. Yes.

The CHAIRMAN. Does anyone else want to add any comments about the automobile industry?

Mr. FRIEND. I have seen some rough estimates of seasonally adjusted domestic sales for December and January. They were at an annual rate of 5.9 million cars in December of 1958 and 5.6 million in January of 1959. But though these figures themselves don't look too bad, as Mr. Paradiso pointed out it is much too early to say what this means for the coming year.

The CHAIRMAN. If you had an average of 121,000 cars per week in January of last year on a weekly basis, that would have been up around 5.9 last year.

Mr. FRIEND. In January of 1958 sales were 380,000. In January of 1959, they are now estimated at 440,000, which is a fair increase.

The CHAIRMAN. In other words, when do you think we will know as to when the new models are going to catch on?

Mr. FRIEND. A month or two still.

The CHAIRMAN. Do you agree with that, Mr. Paradiso?

Mr. PARADISO. Yes. In a couple of months we should know.

The CHAIRMAN. By the end of February.

Mr. PARADISO. The end of March. A good deal depends on the weather. The weather is an important factor, particularly at this time of the year. I would say by the end of March, when the season opens up—

The CHAIRMAN. You mean in the spring a young man's fancy lightly turns to thoughts of spinning on the open road?

Now, may I ask this question. This question is about capital investment. Is it true that we are not likely to have significant increases until we get toward the latter part of this year?

Mr. PARADISO. The office of Business Economics and the Securities and Exchange Commission are just now completing the annual survey of businessmen's capital expenditures program for 1959. Unfortunately we don't have the tabulations as yet.

There are two sources of evidence that we use for gaging the trend of capital outlays. One is the recent survey we made which did not show any marked upturn in plant and equipment spending as far as the first quarter this year was concerned compared with the fourth quarter last year. Private surveys show pretty much the same kind of result; no significant rise in 1959 compared with 1958.

Since we don't have a more recent survey, I have been looking into the orders received by the producers durable goods firms. After eliminating the orders associated with consumer major appliances, so that we get an idea of what the producer's orders would mean, I have concluded that at the present time there is no evidence from orders received by industrial machinery producers, metalworking machinery firms, and other producers of equipment that a marked rise in capital spending is in the offing 6 months or so hence. Such orders have not as yet advanced significantly.

So, therefore, at the present time I am not at all convinced that later this year we will see any sizable increase in capital outlays. I would like to see some kind of a turnaround in these orders before I conclude that capital expenditures will show a marked rise.

The CHAIRMAN. Now, may I ask about housing?

Am I correct in my understanding that the total number of housing starts for 1958 was approximately 1.2 million?

Mr. NEWCOMB. As recorded by BLS, yes.

The CHAIRMAN. And the rate for December was 1.4?

Mr. NEWCOMB. 1.43.

The CHAIRMAN. And that you estimate total volume for 1959 at 1.3?

Mr. NEWCOMB. Assuming that there is no sharp curtailment in mortgage funds available.

The CHAIRMAN. May I ask, then, where the pickup in business is expected to come from?

Mr. NEWCOMB. You mean you are asking the other members of the panel?

The CHAIRMAN. No.

Mr. NEWCOMB. All right. That is my question.

The CHAIRMAN. Yes. I think we might start with you.

Mr. NEWCOMB. Well, one inventory liquidation is over. I think that Mr. Friend and Gainsbrugh and Bill here have all pointed out that the inventory liquidation is shifting from negative to positive. Consumer expenditures are rising.

That is definitely going up.

Local expenditures will go up $3 billion.

Each of these is positive.

The CHAIRMAN. You mean you are depending upon an increase in public expenditures to get recovery.

Mr. NEWCOMB. Public expenditures will help. Inventories will help very definitely. And consumer expenditures also are rising very helpfully.

The CHAIRMAN. Did you want to add to that?

Mr. BUTLER. Well, it seems that you will get by midyear a definite and perhaps rather sharp upturn in plant and equipment expenditures. I think it is a little too early yet for this to show up in orders data. But it should in the next month or two. I think you will begin to see the signs in the order data of what I expect to be a rather vigorous upturn in business investment.

Mr. PARADISO. Why?

Mr. BUTLER. For a simple reason. Earnings are very good. And they aren't going to give them to the stockholders.

The CHAIRMAN. Mr. Bean.

Mr. BEAN. May I amplify Mr. Butler's remark?

I would suggest that you turn to the chart in Mr. Gainsbrugh's exhibit which deals with your last question, the question of expenditures for plant and equipment.

We are at the stage in forecasting business items these days where the greatest wisdom is derived by comparing what happened in the past. So, therefore, I would suggest that that chart be examined in this manner. That the line which is marked 1957–59 be moved back one quarter so that the low point which is the last quarter of 1958 would coincide with the low quarter in that dotted line.

In that case you will get a very strong hint that we have turned the corner and that we are on the upgrade following the pattern of 1948–49.

And, similarly, if you compare the current curve with the low point of the curve, 1953–57, that, too, suggests that you are on the verge of, if you are not already getting there, this sharp increase in expenditure that Mr. Butler alluded to.

The CHAIRMAN. I want to conclude on one question that I will throw out. Probably we will not have time to answer it.

We took testimony last year at this time. We had a large number of economists state that there was a recession. That seemed to be denied by the Council of Economic Advisers at the time. Figures seemed to indicate a recession. Then we asked them to prescribe for a recession. The overwhelming majority advocated the tax cut.

So, fortified with this, I presented an amendment to the tax laws to put a tax cut into effect. It was defeated on two occasions. We were told that we were going to be out of the recession by June or at the most by late summer.

Now, we are told that we will be out of the recession sometime in 1959. I would like to have you go back over the past and ask: Suppose we had put a tax cut into effect of the dimensions which we advocated; would this have brought us out of the recession, in your judgment, at a markedly earlier time?

Mr. FRIEND. May I say that I think you gave the right prescription a year ago, even though at that time both Mr. Butler and I and others were projecting a rate of activity in the fourth quarter of 1958 which was not terribly different from the actual rate achieved.

But, speaking now for myself, I had the feeling, and still do, that we could ill afford to lose the magnitude of output that we would be losing in the intervening period.

Second of all, when the rate of unemployment is over 7 percent and you are predicting something like 6 or 7 percent a year hence, there is enough margin of error in the prediction so that, if it is wrong in the direction of being too optimistic, we might face a very serious situation.

So I think that the people who did not take your prescription were sort of playing Russian roulette with the barrel pointing outward.

The CHAIRMAN. That is the analogy which I used. But I was accused of being too brutal. Does anyone else want to make a comment on it? Also a number of very eminent financial writers accused me of being too brutal.

Representative CURTIS. I would like to ask a couple of questions.

These are detailed questions.

Mr. Newcomb, in computing housing starts, some people have commented that there has been considerable increase in purchase of trailers.

Are trailer figures taken into account in the overall picture of housing? Or is that a relatively insignificant item?

Mr. NEWCOMB. Trailers are significant. Over 129,000 trailers were sold in 1958 and over 142,000 in 1957. The number sold for permanent use in 1958 came to over 100,000. The number sold for permanent use, in 1957, I think, was around 125,000.

The trailer competes with the apartment house. Each one performs a function, particularly for very young or relatively old families. I think they should be counted. The better trailers which are being built now are 50 feet long, and 10 feet wide, and have very satisfactory living facilities for many types of families.

Mr. CLAGUE. May I say a word about that?

Representative CURTIS. Yes.

Mr. CLAGUE. You should understand those trailers are not in the housing starts figures that you are quoting from the Bureau of Labor Statistics.

Representative CURTIS. I thought they weren't. Of course the financing is a lot different too in that area.

Mr. NEWCOMB. They are being financed over a somewhat longer time. Their financing record is good. Purchaser will give up the auto before they give up the trailer.

Representative CURTIS. You mentioned these institutional blocks in this housing field. Do you think there is any—is there legislation that is needed in this Congress to remove those?

Mr. NEWCOMB. I would like to see in the pending bills an amendment which would authorize savings and loans to borrow directly and which would exempt such borrowing from SEC inspection.

The point here is that savings and loans are already supervised by the Federal Savings and Loan Insurance Corp.; so that the publishing of 5 years of annual reports and other things of that sort which SEC requires, and rightly in an ordinary operation, becomes an expensive operation, and I think a needless additional expense.

So authorizing savings and loans to borrow directly, say, up to 30 percent of their deposits, would, I think, expedite the flow of funds. That would be a very simple legislative thing.

Too, I would like to see FNMA authorized or maybe instructed to borrow on long-term debentures.

Representative CURTIS. That would have to be done by legislation.

Mr. NEWCOMB. I don't think so. They could do it, but at present they are under control of the Treasury. Obviously the Treasury works with the Housing Administrator's Office because it doesn't want competition in long-term funds. That is a perfectly natural operation.

But if General Motors wants to borrow or General Telephone or General Aniline wants to borrow; it doesn't have to ask the Treasury, "Please, may I expand my capacity?"

The homebuilders do.

The result is reduction in homebuilding from the standpoint of a prospective home buyer.

I think that this is unfortunate. So I would like to make the home financing industry independent of the Federal Treasury, as independent of the Federal Treasury as general industry is financed independent of the Federal Treasury.

Then I would like to have FNMA either authorized or instructed to make loans against mortgages so that the mortgagee holding FHA mortgages could do the same as the savings and loans can do today, put up their mortgages as security.

This would give a flexibility which the owner of FHA mortgages doesn't have today.

He has to sell them and buy them back if he needs money in a hurry. I think we have developed rigidities as a result of historical accidents which are interfering with housing.

Representative CURTIS. Mr. Butler, one question on legislation. You mentioned the increased financial investment aboard. Do you feel that there is any legislation needed to stimulate further investments abroad?

Mr. BUTLER. Well, this is a pretty complicated question. I understand there is a bill—I think it is the Boggs bill——

Representative CURTIS. May I say this because we are running short and because it might be complicated.

If you had answered "no," why then it would have been easy.

I wonder if you would supply your statement for the record on that question?

Mr. BUTLER. I will answer it, yes.

Representative CURTIS. Thank you.

The CHAIRMAN. Thank you very much, gentlemen.

We will meet again tomorrow morning in this room with a panel on policy implications, economic outlook, with primary reference to tax policy and monetary policy.

Thank you very much.

(Whereupon, at 12:10 p.m., the committee recessed, to reconvene at 10 a.m., Friday, January 30, 1959.)

# JANUARY 1959 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, JANUARY 30, 1959

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met at 10 a.m., pursuant to recess, in room 362, Old House Office Building, Senator Douglas presiding.

Present: Senator Douglas (presiding); Representatives Patman, Bollings, Reuss, Curtis, Kilburn, and Widnall.

Also present: Roderick H. Riley, executive director; and John W. Lehman, clerk.

The CHAIRMAN. May we come to order.

First, may I say, for the benefit of the few members of the press who are here, we have prepared a release on next week's program, which starts next Monday, and the release indicates the witnesses and the main subjects which we want them to cover.

We are very happy to welcome our distinguished group of economists this morning. I was once an economist myself, and I should like to warn you about an occupational hazard which we frequently succumb to. Our time is limited, and I wonder if you gentlemen could restrict yourselves to about 7 minutes in your original discussions. Then, after you have completed your presentation of material, we will have discussions back and forth between you and members of the Senate and House committee.

The general subject this morning is "Policy Implications of the Economic Outlook," with special reference to tax policy and monetary policy during the coming year.

We are very glad to introduce first an old friend, Prof. Richard Musgrave of the University of Michigan.

## STATEMENT OF RICHARD A. MUSGRAVE, PROFESSOR OF ECONOMICS, UNIVERSITY OF MICHIGAN

Mr. MUSGRAVE. Mr. Chairman, may I be excused if my statement does not quite adhere to the points in the agenda which you have submitted, because I prepared it before the agenda was received.

The CHAIRMAN. Yes.

Mr. MUSGRAVE. Before turning to the budget outlook, I should like to comment briefly on the performance of fiscal policy during the past 2 years.

The anatomy of the 1957–58 recession, as I see it, is as follows.

We had a sharp decline in investment expenditures, especially on producers' equipment and inventory, of $18 billion, together with a decline in net exports of $3 billion. These contractive forces were offset in part by an increase in goods and service expenditures of Government by $4 billion, leaving a net decline of $17 billion. All figures refer to changes from the third quarter of 1957 to the second quarter of 1958.

Since total consumption expenditures remained constant, this equaled the total drop in GNP. The constancy of consumption expenditures, while startling at first sight, reflects a nearly unchanged disposable income. The latter declined by $1 billion only, notwithstanding the $17 billion decline in GNP, largely for two reasons. Government transfers to persons rose by $5 billion, and corporate profits fell by $10 billion.

Since dividend payments remained unchanged, the decline in profits was reflected wholly in reduced profits, taxes, and retained earnings. Other taxes, such as personal and consumption taxes, did not change significantly.

In all, the budgetary performance was in the right direction, but the credit goes very largely to the expenditure side. The total increase in expenditures—goods and service plus transfer—of $9 billion was a significant factor in dampening the depressing effects of declining investment.

As far as the increase in goods and service expenditures goes, little praise can be claimed by Federal policy, three-quarters of the gain being in State and local outlays and more or less unrelated to the recession problem. The response of Federal transfer payments, however, was splendid. They reflected a high degree of legislative response and built-in flexibility, which may be counted on again as similar circumstances arise in the future.

While transfer payments were the hero in the piece, the much heralded built-in flexibility of the tax system contributed but little. To be sure, receipts of the corporation profits tax fell by $7 billion, but I venture to guess that this made little difference. A lesser drop would have been reflected in reduced retention of earnings rather than in lower dividends or investment outlays. (While the resulting increase in corporate liquidity might have a delayed effect in the recovery stage, this is a different matter).

Putting it differently, Federal fiscal policy was not as good as is suggested by the change from an annual rate of surplus of $4 billion to a deficit of $10 billion.

Since personal income did not decline, personal taxes remained unchanged as well, and since disposable income and consumption expenditures showed little change, indirect taxes also remained stable.

While we cannot blame personal and indirect taxes for remaining unchanged in response to a constant tax base, this nevertheless points to an important moral: little effective help can be expected from the built-in flexibility of tax yield in the earlier stages of a decline, such help becoming effective only after the decline has become sufficiently severe to cut significantly into the level of personal income. It follows that provision for a highly responsive system of transfer payments, that is, substantial early unemployment benefits, becomes of crucial importance as the first line of defense.

There is a good deal of satisfaction in the President's report with having avoided—

hasty and disproportionate actions, such as tax reductions, that needlessly endanger the prospects of future fiscal balance and prejudice the orderly revision of the tax structure.

I beg to differ. While the recession proved less sustained, we hope, than some people expected a year ago, it seems to me, as a matter of hindsight at least, that it would have been clearly desirable to have cut income tax rates, effective with the second or third quarter of 1957. In this fashion, disposable income might have been raised by, say, $10 billion, thus inducing an increase in consumption expenditures which would have provided a further and much needed offset to the decline in investment.

While this recommendation is by hindsight—I myself cautioned against a premature tax cut when appearing before this committee in June 1957, and recommended a tax cut only when appearing in April 1958—I see little reason for satisfaction with a policy of insufficient action, a policy which, in fact, has led to a sustained period of heavy unemployment. Surely, this magnitude was in excess of what can be accepted as necessary for an orderly functioning of our economy.

Also, I disagree with the proposition that tax cuts to fight a recession must be avoided because they might weaken the possibility of achieving a balanced budget or a budget surplus, which may be required at a later time to check inflation. This is too defeatist a view. We must learn to vary tax rates over the cycle, and not just rely on the built-in flexibility of yield.

Having suggested ways in which such a policy may be implemented in an earlier appearance before this committee, I will not do so again (Joint Economic Committee, Subcommittee on Fiscal Policy, Apr. 30, 1958. See also my testimony in General Tax Revision Hearings, Committee on Ways and Means, Jan. 30, 1958). However, I do wish to record my view that the recent experience has not weakened the need for such a policy, and that steps should be taken to provide for it.

The budget outlook: I am now turning to the outlook for budget policy. There being no time for a detailed appraisal of the administration's recommendations, I shall only comment on some points of major importance.

1. The central theme of the President's budget message and of the fiscal sections of the Economic Report is that we are to have a balanced budget, while at the same time providing for all the essential services that are needed. Both objectives are to be met by holding present tax rates constant.

While this may be a happy circumstance, the coincidence is rather too good to be true. As to the defense budget, it is evident that proposed outlays fall considerably short of what was recommended by such impartial and expert sources as the Rockefeller report. With regard to nondefense programs, especially education, the budget proposals are exceedingly limited and restrictive. I do not believe that they are adequate, and it is my impression that the concept of what is essential was made the dependent variable, to be determined as a function of what could be considered the most optimistic estimate of tax yield.

All this is not to say that I disagree with the objective of a balanced budget, provided that the administration's highly optimistic expectations for continued recovery materialize. However, I should have chosen an alternative approach to determine needs, and then to recommend such increases in tax rates as would be required to meet them. Also, I am not persuaded that the economy in the months ahead will be so buoyant as to require a wholly balanced budget. In particular, there seems to be somewhat of a conflict between the thesis that the budget must be balanced if inflation is to be avoided, and the great stress, placed in other connections, on the danger of excessive wage demands as a source of inflation.

2. I am disconcerted with the suggestion that, given a prudent expenditure policy, we may look forward to using the gains in tax yield, incident to the growth of the economy, for a reduction in tax rates.

While it is true that the yield from present tax rates will rise as income grows, providing for a gain of, say, $25 billion over a 10-year period, I very much doubt whether much or any of this will be available for cuts in tax rates.

Let us assume that general economic conditions will be such as to demand a balanced budget, and then consider these four cases: (1) The international situation undergoes a revolutionary change for the better and defense expenditures can be cut sharply; (2) the international situation develops such that we shall be able to hold defense expenditures at present levels; (3) defense expenditures must rise at the same rate as the gross national product; and (4) defense expenditures will have to rise at a faster rate.

In case 1 we would obviously be able to cut tax rates sharply while, at the same time, providing for greatly increased civilian services of Government. In case 2 we might be able to cut tax rates somewhat, since not the entire growth increment in yield may be needed for civilian purposes. In case 3 I see no chance for reduction in tax rates. Indeed, increases may be needed to meet civilian needs, if not at the Federal then surely at the State and local level. In case 4 an increase in tax rates will clearly be needed.

While I am no expert in international affairs, I feel satisfied that case 1, however beautiful, is not deserving of serious consideration at this time, and that case 2, as well, is highly unrealistic. Therefore, I find it most unwise to present the silver lining of early tax reduction, a prospect which to me does not seem in the cards for a responsible national policy.

In past years there has been a good deal of concern, in various statements of the administration and others, that the necessity for heavy defense expenditures, combined with the need for meeting the civilian responsibilities of Government, poses a tragic dilemma. Provisions for adequate defense may well undermine the health of our economy, thus making the very defense effort impossible. While this fear is not expressed in either the budget message or the economic report, I still detect some shadows thereof. I believe it of the utmost importance that they be dispelled.

It would indeed be an irony if the free world were to lose its struggle due to lack of faith in the capabilities of its economic machine or the elasticity of its social institutions. And it is no less dangerous to permit such a fiction to balm the conscience of those who are unwilling to meet their responsibilities in this struggle.

To put it more specifically, the health of our economy does not demand tax reduction, even though we should all prefer a world in which tax reduction were possible. And the health of our economy will not be undermined if an increase in tax rates becomes necessary, even though we should all prefer a world in which this was not needed.

Whatever the real need for increasing outlays on defense, economic aid, education, and so forth, the issue at stake is not the health of our economy. The issue at stake is how necessary we consider these things to be, and how willing we are to surrender some of the things which we would have to go without in return.

3. Turning now to a more specific point, let me note a disturbing trend in recent years involving a tendency to move various expenditure activities outside the budget, or to make special provision for earmarked finance within the budget, arrangements which result in a more favorable budget picture than would be obtained if the budget was presented on a comprehensive basis.

Such practices not only distort the picture regarding the economic impact of the budget; worse, they distort the pattern of expenditures by giving preference to those outlays which can be handled in a way which does not interfere with the desire to present a balanced budget. I suggest that your committee make a careful examination of these practices, and consider what may be done to assure presentation of a truly comprehensive budget picture.

4. Next I should like to record my support for the President's recommendations to improve budgetary control. I am in agreement especially with the suggestion to reconsider procedures which might accomplish the objectives initially aimed at by the Reorganization Act of 1946. And I also feel that we must face the problems underlying the President's recommendation for an item veto.

5. Finally, there is the recommendation to include price level stability among the objectives of the Employment Act. Surely, price level stability as well as high employment is an objective of stabilization policy. Yet, if price level stability is made a coordinate objective, the requirements of the act may become ineffective unless the Executive is burdened with the further responsibility of recommending means by which both objectives can in fact be met.

The CHAIRMAN. Thank you, Mr. Musgrave. And, if you have time and are so disposed, I would appreciate it if you would expand your third point to indicate the specific items and amounts which are now being financed outside the budget.

Thank you very much.

The discussion will be continued by Mr. William Fellner, professor of economics at Yale University.

## STATEMENT OF WILLIAM FELLNER, PROFESSOR OF ECONOMICS, YALE UNIVERSITY

Mr. FELLNER. Mr. Chairman, economic forecasts are notoriously hazardous, but it seems to me a good guess that with present tax rates and with the now contemplated budgetary expenditures the GNP of the calendar year 1959 will be somewhat more than $475 billion. This figure is expressed in 1958 prices, as are all other output estimates which I am going to use.

The estimated GNP of between $475 and $480 billion would be about 6 percent higher than the GNP of the calendar year 1957, and almost 10 percent higher than that of 1958.

The margin of 6 percent by which, according to this guess, the 1959 GNP would exceed the 1957 GNP corresponds to 25 to 30 billion. How do we obtain this excess of 25 to 30 billion for calendar 1959 as compared to 1957?

It seems quite likely that in 1959 Federal, State, and local government expenditures on goods and services will exceed the 1957 amount by more than $10 billion in 1958 prices. Certain constituents of private gross capital formation—inventory accumulation and total construction—are also very likely to be in excess of the 1957 amount. So far this points to a presumptive excess of almost $20 billion over 1957, but note that this excess in nonconsumption expenditures might conceivably be reduced to an excess of roughly $10 billion since expenditure on equipment and net exports might conceivably turn out $6 to $8 billion lower than in 1957. This would still leave for calendar 1959 an excess of roughly $10 billion over 1957 in nonconsumption expenditures, a figure which corresponds to about 6 percent of the nonconsumption expenditures of 1957. Therefore, given this excess of roughly $10 billion in nonconsumption expenditures, it seems reasonable to add also a 6-percent excess in consumption expenditures, and this means adding more than $15 billion for the excess in consumption.

We thus have for 1959 over 1957 an excess in nonconsumption expenditures in the amount of roughly $10 billion, and an excess in consumption expenditures amounting to, say, $15 billion. Guesses of this sort are hazardous, but it seems to me that the assumptions on which this total excess of $25 billion is obtained over 1957 are rather on the cautious side. The 1957 GNP was $451 billion in 1958 prices. We therefore arrive at the guess that the 1959 GNP may well turn out to lie in the range between $475 and $480 billion.

2. The experts of the administration may be interpreted as implying that it is reasonable to aim at this GNP of $475 to $480 billion in calendar 1959, and perhaps for somewhat more than $480 billion for fiscal 1960, in preference to trying to drive up these figures by a budgetary deficit, and also in preference to lowering the money value of the output in question by creating a budgetary surplus.

I happen to agree with the value judgments on which this conclusion is based, but I regret that the official argument places mechanistic rules of thumb in the foreground instead of justifying the case rationally on its own merit.

What are essentially the implied value judgments?

The main implicit judgment here is that a more than 10-percent rise of the GNP from 1958 to 1959—or, alternatively, a more than about a 7-percent rise from the last quarter of 1958 to the last quarter of 1959—would involve an acute risk of inflation such as should be avoided even if the $475 to $480 billion GNP should not create full employment in a very ambitious sense of this word.

Unemployment as a percentage of the labor force will almost certainly be smaller at the contemplated GNP than it is now, but by how much is a question which depends on the increase in the labor force, on the increase in the length of the workweek, and on the rise in man-hour output during the expansion.

Given the present characteristics of the labor market and of the industrial markets, we do not know at what degree of employment inflationary pressures would start to become acute again. We are faced here with a matter of value judgments, but I, too, happen to feel that trying to go even faster would involve serious risks.

I may add here a sentence to the effect that I don't really believe we should give up on somewhat more ambitious programs of full employment. But this, I think, would require first reducing the monopoly power of unions and also of firms if we want to accomplish it without appreciable inflation and without direct controls.

3. To say that one favors aiming at a balanced budget for a roughly $480-billion GNP does not in itself imply favoring that this balance should be sought at a $77 billion level of spending and taxing. Is this level of spending too high, too low, or just about right? I will limit myself to two brief observations.

My first observation relates to a group of fiscal expenditures which may be defined as total expenditures minus national defense expenditures minus veterans' benefits minus agricultural price support minus interest on the debt.

After a 25-percent cut in fiscal 1954, the nondefense expenditures so defined have been rising at a somewhat higher proportionate rate than the GNP except that after this year's jump, which resulted from decisions made during the recession, next year's figure will be smaller than this year's even if it will be 10 percent greater than that of 1958. For a 5-year period the rise is about 25 percent in real terms in this type of budgetary expenditure which does not include the partly similar and also appreciably rising expenditures through trust funds and long-term loans to communities.

Some critics object that those nondefense expenditures out of general revenue which I am now considering are still too low—they account for $13.5 billion of the planned $77 billion of spending—and others object that these expenditures have been rising too rapidly. But it would be quite unreasonable to deny that a growing economy needs rising expenditures belonging in this general category, and something can be said for a policy which makes gradual adjustments more or less in accordance with growth rates in the economy.

I come to my last observation, which relates to the defense budget. With correction for price changes, our defense expenditures have now been kept just about constant in absolute terms for many years. Considering that the GNP has been growing, and considering that Russia has made gains along various lines, one's impression here is that thrift is being used at the wrong place. This impression may of course be misleading because in some cases improvements hinge almost exclusively on organizational moves with little dependence on additional money. At best this question can be cleared up with the aid of military experts; and the economist can make only one relevant comment.

The difficulty of raising additional money for specific military programs is not a difficulty of overtaxing the Nation in any ultimately meaningful sense. The American standard of living could stay very high even if additional taxes were levied for defense. The difficulty is that if, guided by equity considerations alone, we collect further taxes primarily from the middle and high-income groups, we are likely to reduce our long-run growth rate, partly because by this method of taxation we reduce the saving ratio out of national income in the private sector, and partly because in the long run a tax burden concentrated on the margin of earnings reduces economic incentives.

If, on the other hand, we levy additional taxes for specific defense programs in a nongraduated fashion—say through a flat-rate deduction from practically all disposable incomes or through a sales tax—then it is possible to object that our policy shows insufficient regard for equity. But if an adequate missile program or some similarly vital objective should depend on additional expenditures, then we are confronted with a special situation and must not be held back by such difficulties. Difficulties of this sort are political; they are not rooted in physical limitations.

Here again we are in the area of value judgments. My own preference would be to stress the growth aspect of the problem, because to strengthen military defenses at the expense of growth rates would be partly self-defeating, and also because higher growth rates bring a steeper uptrend in real wage rates and, thus, bring benefits to practically all groups in the economy.

I feel that if, either because of additional military expenditures or for any other reason, we should become faced later in the year with the necessity of strengthening our anti-inflationary policies, then our tax policies and our credit policies should be devised in such a way as to restrain consumption more than investment. Even as things now stand, our lines of credit policy and of tax policy are apt to contribute to a rather low investment-to-consumption ratio in 1959.

The CHAIRMAN. Thank you, Mr. Fellner.

The next discussion is by Mr. Walter W. Heller, professor of economics at the University of Minnesota.

## STATEMENT OF WALTER W. HELLER, PROFESSOR OF ECONOMICS, UNIVERSITY OF MINNESOTA

Mr. HELLER. In its preoccupation with the problem of inflation and the goal of price stability, the 1959 Economic Report provides a natural point of departure for a discussion of policies appropriate to the present economic outlook, for if price stability is not the transcendent economic issue of 1959, and if inflation is not a clear and present, or omnipresent, danger, the report has missed its mark.

That half of the President's letter of transmittal which lays down economic policy for the future is concerned entirely with stable prices as related to economic growth. Price stability and its synonyms appear 14 times during the two pages of policy discussion. Similarly, chapter 4, which programs future economic policy, presses home the case for price stability and the measures to promote it, before turning to other aspects of economic growth.

A balanced Federal budget is the chief offering at the altar of price stability:

> The principal means by which Government can express leadership in the effort to preserve price stability is to conduct its own financial affairs prudently. The budget submitted to the Congress for the fiscal year 1960, which balances expenditures with receipts at a level of $77 billion, seeks to fulfill this responsibility.

Are the sacrifices of military and civilian programs which lie behind the balanced-budget offering justified in terms of the present economic outlook? Would further deficits in the next 12 to 18 months run off in price inflation, or would they continue to stimulate production and serve the cause of recovery?

The answer lies largely in the amount of slack left in our economy and the rapidity with which natural economic forces will take it up.

Substantial manpower slack is reflected in the current 6.1 percent adjusted rate of unemployment, the 40.2-hour manufacturing workweek, and the potential enlargement of the labor force. Even more slack is reflected in the figures on plant capacity. In the 17 basic materials industries, such as steel, copper, cement, textiles, selected chemicals, on which the Federal Reserve Board maintains unofficial capacity and output indexes, current production represents only 76.5 percent of capacity, an output index of 140 against a January 1959 preliminary capacity index of 183, both on a 1947–49 base.

It is hardly surprising that plant and equipment outlays continue to lag $8 billion, or nearly 20 percent, below their 1957 peak. Only a brisk revival of markets will bring full recovery here.

Finally, if the productive potential of our economy in mid-1957 was close to $450 billion, it will have risen to $500 billion by the end of 1959, taking account of (*a*) the accelerated growth rate we typically enjoy in climbing out of a recession, and (*b*) the intervening rise in the price level.

The official Treasury forecast of a $480 billion GNP rate at the end of the year implies that, apart from bottleneck problems, a substantial cushion to absorb the impact of rising demand will still exist. In short, the large amount of unused productive capacity throughout the economy provides substantial protection against demand-induced inflation in the near term.

As to cost-push inflation, our best defense is increased productivity. If we can increase the return of output per unit of input fast enough, we can satisfy the rising demands for higher wages, higher profits, and higher farm prices by sharing in expanding product rather than by pushing up the price level. Here, the immediate prospect is excellent. Productivity is rising sharply as the economy reaps the benefits from (*a*) the 1955–57 surge of investment in plant and equipment—as well as in professional and technical personnel, as the report cogently notes—and (*b*) recession-induced measures to cut costs and improve managerial efficiency. Also, as output rises toward optimal output-capacity ratios, unit costs will fall.

These pleasant economic conclusions are reflected in Secretary Anderson's estimate of a jump in corporate profits from $36.5 billion in 1958 to $47 billion this year. The prospect for satisfying appetites for higher profits and higher wages without higher price seems excellent at this stage of our economic recovery.

When total demand again presses hard against our productive resources, our monetary weapons will operate in a more favorable setting than during the boom following the 1953–54 recession: Liquidity is lower in the household, business, and banking sectors; bank holdings of short-term Government bonds are relatively lower; saving continues at a high rate; and consumer expectations seem much more subdued than in 1955.

If the foregoing assessment of the economic situation is correct, an obsession with Federal expenditure cutbacks and early budget balance as a prerequisite to price stability is unfounded. Continued, though shrinking, budget deficits appear likely to be reflected in expansion of output rather than inflation of prices for some time to come. Budget cutting and budget balance may be urged to hold or cut the Government down to size, perhaps in the conviction that Government use of resources promises lower returns than private use of resources, or that expansion of Government endangers freedom.

In our present external context, which confronts this country with the possibility of annihilation or humiliation, and in our present internal context, in which much of our affluence is being frittered away in indulgences, luxuries, and frivolities, I would sharply disagree with this position. But, at least, it would not be built on such an uncertain economic foundation as the stability argument for budget balance. In addition to the basic deficiency of this position, the setting of the budgetary target for price stability in terms of the $77 billion administrative budget rather than the $93 billion cash-consolidated budget is a serious technical deficiency.

In the projections of tax policy for the future, the President's Economic Report also employs questionable economic logic, for if deficits are injurious to price stability, as the report contends, symmetrical reasoning suggests that surpluses which develop out of boom conditions would be beneficial in dampening inflationary forces. Under these circumstances, it seems strange that the President should hold out the prospect that, given continued recovery and a tight rein on Federal spending, "a significant additional step in tax reduction and reform can be taken in the reasonably foreseeable future."

It is worth noting that the peak budget deficit occurred in the second quarter of 1958, at $9.9 billion, as shown in the national income accounts, report, page 120, and has been shrinking since that time—to $8.6 billion in the third quarter and $7.2 billion in the fourth. In a dynamic sense, therefore, the Federal budget has been a declining stimulus, which must be offset by other stimuli if recovery is to continue at a brisk pace.

The argument thus far questions the basis for concluding that inflation is such a clear and present danger as to call for Federal expenditure paralysis at the level of budgetary balance. But even if inflation were a more immediate and menacing problem, the President's report fails to give us a balanced basis for judging the primacy of price stability in current economic policy. To make this judgment requires a balancing of benefits against costs, of the risks we incur in biasing our policies toward price stability rather than, say, toward full employment.

Yet, the potential costs of a restrictive budgetary policy to promote price stability are great: loss of production by slowing the pace of recovery; lower investment in public education and other public services that strengthen our long-run economic and military potential: attempts to push functions back on State and local budgets which are already under such extreme pressures, compounded by the adverse effects of recession, that at least two-thirds of the State legislatures must raise tax rates in 1959; and, perhaps tragically if we are to believe the Gaither, Rockefeller, CED reports and General Gavin's statements on national security needs relative to Russia's advances, a laggard defense budget.

To the extent that these results are risked in the name of price stability and balanced budgets, they represent as great a risk, calculated or otherwise, as this country has ever incurred in peacetime economic policy.

The CHAIRMAN. Thank you very much, Mr. Heller. We are very happy to have you here.

Mr. Ratchford, we will be very pleased to have your statement.

## STATEMENT OF B. U. RATCHFORD. PROFESSOR OF ECONOMICS. DUKE UNIVERSITY

Mr. RATCHFORD. After the sharpest and deepest economic recession since World War II we have now had, for the past 9 months, an equally sharp and extensive recovery. This recovery has, according to the best estimates, brought gross national product, national income, personal disposable income, and personal consumption expenditures to levels slightly above the peaks reached in 1957. Although there are grounds for uneasiness on several points, there is as yet no positive evidence of any slackening in this recovery. Employment and investment in producers' durable equipment are the two major indicators which remain substantially below their 1957 peaks, while industrial production is slightly below its previous high point.

Prices generally never declined significantly, and in recent months have resumed their rise. The index of wholesale prices for industrial commodities, perhaps the most significant measure for use here, has risen each month from June 1958 to the present, and is now 1.7 percent above the June figure. This is equal to an annual rate of increase of about 3 percent. If we are to have reasonable price stability, certainly nothing should be done to accelerate this rise, and perhaps steps should be taken to curb it if possible.

The policy of the Federal Government for the period immediately ahead, as set forth in the budget and the President's Economic Report, is to avoid any new measures to stimulate the economy, to reduce expenditures wherever possible outside the area of national defense, and to emphasize the need for price stability. In my opinion, this policy is justified and desirable for several reasons:

1. Many of the measures taken last year to stimulate activity are still effective and will continue to be felt for several months to come. This is true of the acceleration of highway expenditures and of the special funds released to aid housing. It is even more true of the funds being requested for the expansion of the capital of the International Monetary Fund and of the International Bank for Reconstruction and Development, since the effects of these funds will be felt entirely in fiscal 1960 and later years.

2. If recovery continues at the pace attained during the past 8 or 9 months, there will be no need for additional fiscal aids. On the other hand, if there is any significant relapse, Federal revenues will fall below budget estimates and there will be a substantial deficit which will contribute toward supporting demand.

3. The real reduction in expenditures is not nearly as great as the budget figures indicate. A large part of it is caused by the noncur-

rent expenditure for the present year represented by the funds being requested to expand the capital for international financial institutions.

4. The economic effects of expenditures will in several instances be achieved by activities which will not be reflected by expenditures in the budget. These are illustrated by the requested increase in the authority to insure private mortgages, by the increased purchases of mortgages from funds realized through the sale of assets by the Federal National Mortgage Association, and by other cases of the increased participation of private capital funds in the activities of Federal agencies.

For these reasons and others, I believe that the economic policy which has been announced, which is essentially one of "hold the line," is the proper one under existing conditions.

In this connection I would like to call attention to a feature of the budget which is mentioned several times in the President's budget message. This feature might be called "The Dilation of the Expenditure Base" and is essentially a counterpart of "The Erosion of the Tax Base" about which we have heard a great deal.

The Congress makes a broad commitment to support farm prices, provide benefits to veterans, subsidize the Rural Electrification Administration, and so on. Time passes, conditions change, and ways are found to claim funds under these programs for purposes never envisioned in the original act. The result is a steadily increasing amount of expenditures which are beyond the immediate control of the Congress or of the Budget Bureau, for purposes which are often not carefully examined and which cannot be adjusted in accordance with the economic situation.

If the present recovery trend continues, our major problem will shortly be to deal with inflationary forces. Indications of inflation, however, are not yet sufficiently definite to justify a general tax increase. Even if they were, I doubt that there would be popular support or even tolerance for such a move. For that reason I am inclined to believe that our principal reliance should be on monetary policy for influencing economic developments. It is much more flexible, and if it is used promptly and with determination it can be effective.

It may well be, however, that before Congress adjourns the trend may be so definite and so strong that the use of tax policy would be justified. In the meantime I would suggest the desirability of a move which might produce a substantial amount of additional revenues without the restraining effect of a general tax increase. That would be a broad and comprehensive move to stop and even to reverse the trend toward the erosion of the tax base. This trend not only reduces revenues but it also lowers taxpayers' morale, makes the income tax less equitable and reduces its efficiency as a built-in stabilizer.

During the past year and a half consumption has held up much better than investment, and it has recovered more rapidly in recent months. Also, I believe that employment has been affected much more by the greater decline in investment and its failure to recover. For these reasons I believe that the recovery would be broader and more stable if our economic policies emphasized investment rather than consumption.

The CHAIRMAN. Thank you very much.

I am now going to call on the author of the most widely studied economic textbook in the country, Mr. Samuelson.

## STATEMENT OF PAUL A. SAMUELSON, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. SAMUELSON. Mr. Chairman, in contrast to last year, when the economy was in a vigorous contraction, we now find ourselves in the midst of an economic expansion. The first part of 1959 will most certainly bring an improvement in production and incomes; and there are no compelling reasons to fear at this time that 1959 will bring back the 1957–58 problems of overall recession.

This switch from contraction to expansion calls for a corresponding switch in the policies and apprehensions of governmental officials. Instead of pressing for massive tax reductions at this time, Congressmen and Cabinet officers should be alert to the possibility that it could become desirable in the year ahead to begin to worry about raising tax rates in the interest of overall stability. And it is only proper that the Federal Reserve authorities should be prepared to make credit more expensive and harder to get in the event that wholesale and consumer prices should again begin a sustained rise.

Let me interject at this point that I would not shop around in the wholesale price index for a component which is rising and worry about that. Indeed, when the industrial sector of the wholesale price index stops rising, the wholesale price index as a whole, I believe, will be falling very considerably. And it would be disastrous in my judgment to try to stabilize each component of that index.

But now, having said all this about the shift toward expansion, I should hasten to point out some of the special considerations which make proper Government decisionmaking difficult at this time.

First, as others on this panel have pointed out, there is the undoubted fact that unemployment, while probably diminishing, is still 6 percent of the civilian labor force, seasonally corrected. This is too high a figure to permit us to be complacent, and our concern for the human suffering and economic waste involved in mass unemployment should inhibit us from putting the brakes on hard against economic expansion. Moreover, the recent apparent rise in labor productivity, welcome as some may regard it from the standpoint of rapidly raising profits from their recession floor, has also the following implication: the greater the increase in productivity, the slower may be the rate at which we eat into our residue of unemployment.

Second as a factor making decisionmaking difficult at this time is the very real possibility that the goal of high employment and rapid growth in productive capacity of the American economy could become economically in conflict with the goal of consumer price stability.

If, as many economists seem to be increasingly persuaded, much of the pressure for higher prices comes from the push of wage and other costs, we could run into a time when the only way to prevent an inflationary price creep would be by a deflationary policy aimed at deliberately keeping employment and capacity slack. Looking ahead only for the next decade, such a "low pressure" policy would, I suspect, slow us up in the crucial economic race that is now going on between us and the Iron Curtain nations of Russia and China.

I do not wish to be misunderstood as being dogmatic on this point. It is quite possible that no conflict between growth and price stability will arise. But economic science cannot at this time be sure that they will always be compatible. My own tentative advice would be to put the major emphasis on growth of real income at our high-employment potential, not letting concern over price inflation dominate our decisions prior to such time as sustained upward thrusts in consumer and wholesale prices have established themselves. In other words, I would run some risk on the price inflation front.

On the question of the proper division of labor between fiscal and monetary policies let me make a few remarks:

Our automatic stabilizers will insure an increase in tax revenues as incomes expand. These fiscal measures are all to the good, and will be reinforced by the reduced transfer payments that a lowering of unemployment will bring. Since I am not prepared at this time to recommend a sizable increase in tax rates or an austere budget, for stabilization reasons, a large share of the shortrun tasks of stabilizing the economy will have to be performed by monetary policy.

As expansion eats into the slack of our economy, and particularly if some definite signs of increases in our price index appear in the months ahead, the Federal Reserve will find itself making open market sales for the purpose of reducing the free reserves of the commercial banks—all this not out of sadism, but in the attempt to slow down the growth of total spending. It will find itself raising the discount rate in order to catch up with the credit tightness it has permitted and created. It may find itself raising reserve requirements of the commercial banks. And if the situation should become more serious than I now envisage it might be necessary for it to ask Congress to invoke specific credit controls that will reinforce general, overall monetary controls. I have reference to direct regulations bearing on consumer credit and possibly on housing credit.

Good management of the economy might make it desirable for the Government to issue long-term bonds at just the time that interest rates are hardening and existing bonds are falling in price. In the interest of stability it may become necessary for Congress to repeal the maximum-rate now payable on Government bonds, I believe now set at 4¼ percent. Such maximums, like similar maximums set on FHA or VA loans and like overall limits set on the public debt, do, in the opinion of most economists, more harm than they do good, and I would recommend their repeal.

On the issue of the proper emphasis to be placed on consumption as compared to investment, economics can be fairly neutral. To the extent that we take seriously the race with Russia, the greater would be the emphasis on investment. But not just any kind of investment such as housing or inventory accumulation. Rather would the emphasis be on plant and equipment expenditure.

Indeed the emphasis for this purpose should probably not be on investment as such, but, rather, on technological change. It would be tragic if, in the interests of economy and fear of some future inflation, the Congress were to cut down on defense spending and thereby cutback on the substantial sums that are now going to support basic and applied research sponsored by the defense forces. Since no private person can hope to recoup for himself all the advantages that accrue to society from the results of scientific and technological discovery, the profit motive is almost sure to be insufficient by itself to give the country the research it needs. Here then is an important need for Government stimulus and support to the most vital of all modern activities—research.

Were I sure that public policy would strongly promote the research so important for our rapid growth, I would be less concerned over the magnitude of capital formation or the precise division between consumption and investment activities.

The CHAIRMAN. Thank you very much.

The discussion will be continued by Mr. Herbert Stein.

## STATEMENT OF HERBERT STEIN, WASHINGTON, D.C.

Mr. STEIN. Mr. Chairman, I am grateful for the invitation to present to your committee my views on the economic problems before the country. I was invited to appear as an individual, and I want to make it perfectly clear that I am not here representing the Committee for Economic Development. I should also note that in the short time allotted to me I shall have to omit some of the qualifications and reservations that would be possible in a longer statement.

What this country needs is a general tax increase.

I recommend a tax increase in order to provide the means to achieve more adequately the three objectives to which the President's budget message rightly gives the highest priority.

Both the budget message and the Economic Report are suffused with the great importance of preventing inflation and with the need for prudent Federal finance as the main Government contribution to this end.

In a table on page 9 of his budget message the President lists his 11 general recommendations. The first two of these are to strengthen the effectiveness of our Armed Forces and to assist free nations in their economic development.

I agree that these are the three top priority objectives; to provide for the national defense, to promote economic development abroad, and to stop inflation.

Now what does the administration's budget propose in support of these objectives?

1. As the contribution of prudent fiscal policy to the war against inflation, a surplus of $100 million on a budget of $77 billion in a $470 billion economy.

2. As the contribution to strengthening the effectiveness of our Armed Forces, an increase of $145 million on a military budget of $40.8 billion.

3. As the contribution to the economic development of the free world, an increase of $80 million in mutual security expenditures for economic and technical assistance.

This looks like a program to cure grave ills by homeopathic doses.

In my opinion the smallness of these numbers is explained by the belief that a general tax increase is out of the question. This is a mistake. A general tax increase would, of course, impose additional burdens upon the American people and would have certain adverse effects upon the economy. But the American people should and would, I believe, be prepared to pay these costs to achieve important objectives.

There are probably not five people in this country who have written more in the past 10 years than I have about the evils of high taxes and the desirability of tax reduction. I know the arguments and do not think I underrate them. There are exceedingly few purposes for which I would recommend a tax increase; probably none besides the three I have mentioned. It is not because I fear high taxes less, but because I fear inflation, military weakness and the unrest in the underdeveloped world more that I recommend higher taxes.

Let me say a few words about each of these three top priority objectives.

The question with respect to national defense is this:

Would additional military expenditures make a large enough contribution to national security to be worth the costs of higher taxes?

This questiton involves the balancing of a military gain from more expenditures and an economic cost from more taxes.

Evidently there is a serious disagreement among informed persons on the extent of the military gain. There is a considerable group that believes an increase of expenditures would yield a substantial gain in national security. This includes the Rockefeller panel, some congressional committees, several high military officers, active and retired, a number of private, civilian students and, according to unauthorized but uncontradicted reports, the Gaither committee. On the other hand, the President, the Secretary of Defense and others apparently believe that the national security gain from more military expenditures would not be substantial. The issue is now in the hands of Congress, which will presumably have highly expert advice on the security consequences of higher military expenditures.

Congress will also have to form a judgment on the economic consequences of the higher taxes that would be needed if military expenditures were raised. This is my only justification for raising the question of national security before this committee. I hope that in making its decisions about the military budget Congress will not be inhibited by the thought that a tax increase would be catastrophic or impossible. The economic cost of raising taxes by X billion dollars would not be radically different from the cost of not cutting taxes by X billion dollars.

I suppose it is by now generally though not unanimously agreed that the United States has a national interest in assisting economic progress in the underdeveloped world. What is still not recognized is the urgency of doing enough.

By the standard of the past behavior of sovereign nations, our policy in the underdeveloped world is a marvel of enlightenment and generosity. Unfortunately we cannot settle for this standard. One of the epochal tides of history is strongly running in the underdeveloped world. It will profoundly affect the lives of our children and grandchildren. Only a Pollyanna can think that this tide is now running in our favor. It is imperative that we try to influence this tide. One of the few means we have for doing this is the provision of assistance to foreign economic development. The obstacles are enormous and perhaps we cannot succeed. But we should not conclude this until we have made the maximum effort we can to help the underdeveloped nations find the path to economic and social progress within a peaceful and democratic world order. Again I urge that in deciding what we can do in so important a cause we should not be governed by the idea that we have reached the limit of taxation.

Finally I come to the problem of inflation and the need for a surplus. I believe we have reached a crucial point in anti-inflation policy. We have had three waves of inflation since the end of the war. We have just been through a recession in which prices did not decline. Our determination to resist inflation is being eroded by the thought that inflation is inevitable. We are being told that labor or business or both will behave in such a way that traditional monetary and fiscal restraints will only succeed in holding down the rate of growth. So we are led down the easy path to acceptance of inflation as a way of life.

The decision to inflate would be a momentous one, even though passive and negative. And rarely, in my opinion, would so important a decision have been made on such flimsy and disputed evidence.

I can only say to those who are persuaded of the inevitability of inflation, "Gentlemen, I beseech you, consider that you may be wrong."

If we accept the inevitability of inflation and relax monetary and fiscal restraints we will certainly have the inflation. We will justify all the expectations of labor and business, of investors and consumers that are said to make inflation inevitable. And in my opinion we would have purchased only a brief respite from the basic problem, which is to make high employment compatible with a price level which, if not necessarily stable, is at least reasonably predictable.

I believe that we must now, before expectations of inflation are solidified beyond removal, make every effort to stop inflation by monetary and fiscal means. I believe, or at least I still hope that firmness in this respect will still induce private behavior that will permit the coexistence of price stability and high employment.

It is because I think this as so important that I strongly support the President's recommendation for a balanced budget. But I do not think the administrative budget surplus of $100 million and the cash budget surplus of $600 million are adequate to the problem. In fiscal years 1956 and 1957 we averaged cash surpluses of $3 billion, and I would aim at such a cash surplus again. Of course, I would set up the budget so that we would get this surplus only at high employment, not at lower levels of activity, and I would be prepared to cut taxes if we should fall seriously below high employment.

These, then, are my three reasons for wanting a general tax increase:

(*a*) We should have a surplus,

(*b*) We should spend more on foreign aid, and

(*c*) We may find it desirable, after further consideration, to spend more on military programs.

A tax increase would not be necessary if we could reduce the President's budget sufficiently outside the national security and foreign aid categories. But the President has made a determined effort to hold expenditures down, and I would have great difficulty in pointing to substantial opportunities for further reduction in the short run.

How much tax increase do we need?

I have in mind something between $3 billion and $5 billion; $3 billion would take care of the surplus plus all the increase in foreign economic assistance that is likely to be feasible in 1 year. Another $2 billion would probably cover all the increase in military expenditures that could be made efficiently in 1 year.

How should we increase taxes?

There is the problem. There are many ways to do it, but any specific proposal raises cries of shocked horror from someone.

It is our inability to agree on how to raise taxes that makes a tax increase seem unthinkable. I think some tax increases would be better than others. But I want to make it quite clear that my recommendation for higher taxes is not contingent upon the adoption of a specific tax program that I might present. My effort this morning is to remove tax increase from the category of dirty words, to get it discussed by the Treasury, by the congressional committees, and by the country. Then we will see what is the best we can agree on.

I realize that there is a danger in any proposal for higher taxes. The danger is that if taxes are raised the revenues will be absorbed by expenditures of minor importance. Then we shall have neither the surplus, nor the stronger defense, nor the larger foreign assistance. This would indeed be a distressing outcome. But it is a risk we must take. We must count on the good sense of the American people and the Congress to avoid this outcome.

The CHAIRMAN. Thank you very much, Mr. Stein.

I wonder if the members of the panel would discuss briefly with each other some of the points of differences which emerged.

I take it that none of you at this time recommend an immediate decrease in taxes. The question is whether existing tax rates should be maintained, whether there should be a general increase, and, if so, what, or whether a third possibility be considered, namely, that a tax reform be engaged in which would plug some of the so-called loopholes.

If it meets with the approval of the other members, I would welcome some discussion on that point by the members of the panel.

Mr. Ratchford?

Mr. RATCHFORD. Mr. Chairman, as I said in my prepared statement, I would prefer the reform. Although I recognize that that is a slower and more difficult route, I believe that this trend toward tax erosion is the most serious problem we face in this country, and I would welcome the attempt to raise a substantial amount of additional revenues through that route.

The CHAIRMAN. Some of us have made calculations that, apart from the question of joint returns, we would raise between $2½ to $3 billion by reducing some of the more obvious loopholes. I wonder if the others have comments on that subject.

Mr. Musgrave?

Mr. MUSGRAVE. Mr. Chairman, given the present outlook, I would not favor an increase in taxes on the assumption that the expenditure level will be as provided for in the President's budget.

If we were to make more extensive provision for some expenditure programs as I would favor I would then also favor that they be supported by increased taxes.

I share Mr. Ratchford's concern for the erosion of the income tax and for the whole problem of improving our tax structure but it may be somewhat dangerous to tie the need for increased taxes if expenditures are to be increased too closely to the need for improving the tax structure.

We ought to improve the tax structure whether we increase the level of taxation or whether we keep it constant or whether we reduce it. This urgncy is equally great in all these cases.

If we are to increase defense expenditures, if we are to increase expenditures for education and so forth, we must provide also for increased tax revenues. I would say let's attempt to obtain this increased tax revenue in a way in which we can get it rather than insist, in the same process, on closing all the loopholes which, by their very existence, give evidence of great political opposition to raising tax revenue by that process.

I favor closing loopholes, of course, but——

The CHAIRMAN. But not now?

Mr. MUSGRAVE. But if we need additional revenue, I would rather not complicate this need too much.

The CHAIRMAN. Mr. Fellner?

Mr. FELLNER. Mr. Chairman, I think that we probably need a higher defense budget, and in that event I would be in favor of raising tax rates. I don't think that that problem can be taken care of simply by tax reforms.

It is quite possible that we could add to our military expenditures without raising taxes and, yet, not reach the so-called full capacity level. But I think that we would get an appreciable inflationary pressure in these circumstances, and this is a consequence of the fact that the present characteristics of the labor market and of the industrial market are such as to lead us in inflationary situations before so-called full employment is reached.

I think this is a very important issue and that it should be faced squarely.

The growth rate in the economy—I think in this regard maybe I disagree with Professor Samuelson—the long-run growth rate I think does not have to depend on whether the unemployment rate is 3 percent or 5 percent. As a matter of fact, I don't think that we will get full employment in this year, and the expansion rate, I think, will be quite considerable during the year. Even in the long run we could be growing at the same rate with a somewhat greater slack, as we can with a somewhat smaller slack.

The slack itself is bad per se. I think it need not affect the growth rate. Obviously, other things equal, it is much better to operate at 3 percent unemployment than at 5 percent unemployment but the long-run growth rate need not be affected by this, and I don't think we can accomplish the objective of a reasonably stable price level with no administrative controls at a 3-percent rate of unemployment, with the given present characteristics of the labor market and the industrial markets. This is really the reason I think that if we add to our expenditures, as we probably should add to our defense expenditures, then we need higher tax rates.

The CHAIRMAN. Mr. Heller, do you wish to give us some information on that?

Mr. HELLER. I am a little bit concerned that we don't seem to move toward tax reform, toward reversing tax erosion, in a recession, because we are in too big a hurry—at least we were last spring—to cut tax rates across the board, which I still think should have been done. Then, again, if we need a tax increase, our attitude seems to be: "Let's get it in the form of increased rates," because we can't really wait to go through the long, hard process of tax reform.

Somewhere along the line we have to take time out for tax reform, and this might be the time. It seems to me we are not under pressure. Even if we were to have somewhat of a deficit for the coming fiscal year, we are not under the same pressure we have been, and this would be a very good time to undertake the reversal of our erosion process in the tax system.

While I have the floor, might I just also note that we shouldn't ignore the fact that in State houses throughout the country tax increases are going to be imposed. There are deficits in State budgets. Some of these are now serving as a stimulus to the economy. I believe that most of these deficits, because the requirement of budget balance in State budgets is so much more rigid, will be overcome by tax increases.

The recent Newsweek survey indicates that at least two-thirds of the States will impose tax increases this year. This should not be ignored in setting Federal fiscal policy.

The CHAIRMAN. Mr. Stein?

Mr. STEIN. You have asked about points of disagreement among us, but I think it is very important to call attention to what I observe as a point of agreement among all of us, which is a point of disagreement with the major lines of economic policy as I observe them being followed in Washington today. That is, I think we have all expressed the feeling that we are not at a limit of taxation.

I think that in one degree or another we all feel that we have become the prisoners of the idea that taxes cannot be raised. Although we may differ among ourselves on the purposes for which we would raise taxes and perhaps on means by which we would raise them, I think there is a kind of agreement here that the acceptance of the present tax structure as a limit of taxation is an element of irrationality which prevents us from making the best decisions in defense of the country and for other purposes.

With respect to the character of a tax increase, I said in my prepared statement:

> I think some tax increases would be better than others. But I want to make it quite clear that my recommendation for higher taxes is not contingent upon the adoption of a specific tax program that I might present.

I don't think it behooves any of us, if we think the purposes for which a tax increase are necessary are really important purposes, to say that we would support a tax increase only if it would be of a kind that we would most prefer.

With respect to loopholes, it seems to me that this is, by definition, something that everyone is in favor of closing. The problem is what is a loophole. I would certainly agree with closing all loopholes. There are, I believe, some loopholes in favor of the Treasury as well as loopholes in favor of the taxpayer. I would mention one—the absence of any averaging in our present tax system, which is a loophole in favor of the Treasury, and there are probably others. But certainly I would agree, if we could agree on what is a loophole, to close it.

Mr. SAMUELSON. I want to express my agreement with Ratchford on the point that most economists, and not just we in this room, are concerned at erosion of the tax base. We consider it in season and out of season to be a task of continuing to try to restore the tax base.

I don't know how I feel on the tactical problem of whether you ought to hold up other tax increases when you need them, waiting upon repairs in the tax base. I also should express the view that the economists have a pretty good idea what a lot of the loopholes are. We have a notion of the definition of income, and there are lots of exceptions legislated to these notions by Congress. I don't think it would be hard to get agreement among technical economists and lawyers as to what some of the loopholes are.

Is this the time for me to touch upon a point that Professor Fellner raised as to possible disagreement between himself and me?

The CHAIRMAN. Certainly.

Mr. SAMUELSON. He raises a question whether we could envisage a model in which an economy with a larger constant percentage of unemployment might not show the same geometric rate of growth as one with a smaller amount of unemployment.

I, too, can envisage such a model, and I am not sure what my opinion would be about its likelihood. My own remarks were directed to the next 10 years. Perhaps, like Khrushchev, I attach too much importance to the immediate future and discount the far future. My proposition was that I suspect that a low-pressure economy, in the interest of stabilizing prices when there is a conflict between price behavior and full employment, will 10 years from now be in a lower capital-goods position, will be in a lower-production position than would an economy which takes some risk on the inflationary side.

I may very well be wrong on that. I don't regard that as a certainty at all.

The CHAIRMAN. Mr. Fellner?

Mr. FELLNER. Mr. Chairman, I would also like to say I believe this would be somewhat a matter of guesswork. As Mr. Samuelson pointed out, it is possible to construct analytical models in which the longrun growth rate is just as high with a 5-percent rate of unemployment as a 3-percent rate of unemployment, but we don't know for sure how it is going to come out. But in the past there were periods with appreciably higher growth rates than those of some of the more recent periods, and in these past periods the average unemployment ratio was, I think, so far as we can tell, in the neighborhood of 5 percent.

I will agree that this does not settle the matter.

The CHAIRMAN. Congressman Patman?

Representative PATMAN. I would like to ask a few questions, Mr. Chairman. Thank you, sir.

First, Mr. Ratchford, of Duke University.

You stated that you believe that we should rely principally on monetary policy for influencing economic developments.

I received this morning the Federal Reserve Bulletin. As a part of our economic policy, including, of course, monetary policy, it seems to be to finance the deficit by letting the banks create the money. During the past year the holdings of the U.S. Government obligations by the banks increased from $64 billion to about $74 billion. Do you know of anything that is nearer print-press money than this?

Mr. RATCHFORD. Well, both bank deposits and paper money, of course, are a part of our money supply.

Representative PATMAN. That is right.

Mr. RATCHFORD. If we are in the stage where an increase in the money supply is needed, it seems to me that this is the only way we could bring about that increase. It is not feasible under our present scheme to print paper money and increase our money supply by that route.

Representative PATMAN. The reason I asked whether you know of any money that is more like paper money than that, is that the reserve requirements of the banks were reduced to enable the banks to buy these bonds. Therefore, they didn't pay anything for them. The 18 New York banks increased their holdings by $2½ billion last year, and the reserves are not only not increased, the reserves are actually decreased. Therefore, they paid nothing for those bonds in effect. Therefore, I say it is practically printing-press money.

Don't you think, Professor, that the Treasury and the monetary authorities should consider, when they have sold all the bonds that they can to people who have the money—individuals, corporations, insurance companies, and others—that if they have got to have the money created just out of the thin air, it would be better for the Federal Reserve to buy those bonds. The interest paid by the taxpayers would then flow back over into the Treasury.

Mr. RATCHFORD. I don't know that I could answer that, Mr. Patman, offhand. Selling them to the Reserve banks, of course, would be much more inflationary than selling them to the commercial banks.

Representative PATMAN. I concede the point, Professor, but there is a way to stop that. You could immobilize those reserves; couldn't you?

Mr. RATCHFORD. Yes.

Representative PATMAN. Therefore, your argument would not be a valid one on that; would it?

Mr. RATCHFORD. If you immediately immobilized the reserves you created, yes, I think that is true.

Representative PATMAN. That is right. In other words, we could save the interest on that $10 billion right now by permitting the Federal Reserve banks to buy these bonds instead of letting the commercial banks create the money to buy the bonds, and we would have no more inflation, if we use the weapons within our power to use. One is to immobilize bank reserves—and, of course, there are other weapons that could be used, too.

I want to ask Mr. Samuelson a question now about this.

I notice you advocate taking the ceiling off of interest rates.

Mr. SAMUELSON. Yes.

Representative PATMAN. I am surprised at your advocacy of anything like that in view of the fact that the last 7 years interest rates have been going up constantly all the time, and they would have gone up much faster and much more if there had not been limitations, according to my view.

If you will take the national debt, the cost of carrying it, the interest rates, which I think are terrible and unpardonable, and I think Congress one of these days will be criticized severely for permitting it.

If you divided that $8 billion by the number of people, you will discover that it is costing each person about $47 a year to carry the national debt now, or a family of five, about $235 a year.

In other words, the higher the interest rate, is it not a fact, Professor Samuelson, the more money is taken out from the private family budgets for interest rates and diverted from the purchase of necessary things? Whether they pay the interest directly on a promissory note or other obligation that they themselves have endorsed, they find their share of interest on the Government debt is in all their bills that they pay, like taxes and the utilities and things like that?

Don't you think that our interest burden has become so excessive that we should give serious consideration to ways and means of lowering it, Professor Samuelson?

Mr. SAMUELSON. Let me say that the reason why I advocate the removing of that limit is precisely because in the whole postwar period there has been an upward trend in interest rates, and that limit is now getting to a point where it is no longer ineffectual. When it becomes effectual I think it is going to become harmful. We are going to have all the subterfuges of accounting that we have seen on the public-debt limit, we are going to repeat the history of centuries of usury laws which, in the interest of making it better for the poor man, actually made it tougher for him to get money.

I think the Government is going to have this same particular problem. I might have a different opinion from you about structural changes in our whole banking system, but at least I could see where such structural changes might accomplish a useful purpose, whereas the fiat of a maximum interest rate, I think, is going to get into our own way and cause more and more trouble.

Representative PATMAN. I know you are honest in your views about that, and you know a lot more about it than I do. But why wouldn't it be better, Professor, to consider having the Federal Reserve fix a maximum interest rate and keep long-term securities at that rate?

For about 15 years the Federal Reserve kept a constant interest rate on long-term Government bonds of 2½ percent and kept bonds at par. They can do it. There is no question on earth about that. You don't dispute that; do you? I mean you don't take issue with me on that?

Mr. SAMUELSON. No. I think that the technical powers of the Federal Reserve are such as to give us almost any interest structure in the short run which they desire. But they must also take the consequences of giving us any particular interest structure, the consequences for the general economy.

Representative PATMAN. That is right; they must. But they have so many weapons, just as was mentioned a while ago. It would be inflationary for the Federal Reserve banks to buy bonds. Certainly, everybody concedes that. But we must not overlook the other weapon that can be used to answer that completely and fully at once by immobilizing the reserves created.

Mr. SAMUELSON. Would you like to have me address myself to the question of what the consequences might be of maintaining a 2½-percent interest rate structure on long-term bonds?

Representative PATMAN. I know your arguments pretty well, Professor Samuelson, and I would like for you to put them in the record in connection with your remarks if you care to. But my time is limited, you see. I only have 10 minutes' time and we don't have time for that.

The CHAIRMAN. You can take more time than that if you want to.

Representative PATMAN. If you would like to, go ahead and answer the question.

Mr. SAMUELSON. I am not insisting on doing so. Usually we ask students to answer questions; so it is only right that I should be made to answer questions.

I suspect in the present state of effective demand, if you are to have even reasonably high employment, let's say 5-percent unemployment, and a reasonable degree of price stability, including possibly a price creep, that if you were to enforce an interest-rate structure across the board that corresponds to a 2½-percent rate on long-term Government bonds, it would be the duty of you Congressmen to greatly overbalance the budget. It can be done. There is more than one way to kill a cat. We can stabilize with a very loose monetary policy, but it will have to be reinforced by a very tight fiscal policy.

Representative PATMAN. You mean the interest rate would be so attractive it would induce us to make appropriations we would not otherwise vote for?

Mr. SAMUELSON. No. What I am saying is that a rate of interest so low would correspond to a rate of investment so high that you would find it necessary not only to follow Dr. Stein here, but to go him one better, two better and three better, to significantly raise taxes, overbalance the budget very much, so that what your left hand—I think I am using the correct hand to describe it—so that what your left hand had done would be washed out by your right hand as far as the overall state of effective demand of the economy is concerned.

Representative PATMAN. I know that is a valid point for consideration. But another reason I bring this up about a limited interest rate is we are in a cold war with Russia. Russia is going into these uncommitted countries that we are trying to deal with, and making loans of $100 million and up to $1 billion at 2½ percent. That is the pattern of Russian interest rates on long-term loans.

If we keep on putting our interest rates up, up, up, and we are having to charge 5 and 6 percent, how are we going to compete with Russia in dealing with these countries that we are trying to keep on our side instead of getting on the side of Russia?

Mr. SAMUELSON. I am not an expert on the Russian economy, but it is my impression that those of our students who have studied the problem have followed a great debate within the Soviet Union as to whether they should use an interest rate or not. While the notion of an interest rate is a bourgeois notion which they do not willingly use, they do, by subterfuge, use the same thing.

I think the findings of the experts is that the actual rates that are charged to the different parts of the 5- and 7-year plan are really very high rates.

I don't think the Russian economy can be regarded as a 2½-percent economy although, for window dressing and with respect to what are relatively small loans, they may charge very low rates indeed.

Representative PATMAN. Thank you.

My time has expired, but, Mr. Chairman, I ask consent that any member of the panel may extend his remarks on that particular point. I don't want to cut anybody off.

The CHAIRMAN. Yes.

Representative PATMAN. And if you have anything to say about the reason why the Federal Reserve shouldn't do this financing when there is no money available, I hope you will express yourselves on that point.

The CHAIRMAN. Mr. Curtis?

Representative CURTIS. Thank you, Mr. Chairman.

I gathered from the papers that no one on the panel would recommend deficit financing for the fiscal years 1959 and 1960. Am I correct in that?

Mr. SAMUELSON. I don't believe I expressed myself on this point. I did say that I was not for tax reduction. But I could well imagine that as we move into fiscal 1960 we will end up with a deficit of still some magnitude, and I would not balk at the prospect.

I should hope that the recovery would be so strong that we would not have a deficit. But I think a number of people on the panel have said that the mere bookkeeping problem of whether the budget is in balance is not the important consideration.

Representative CURTIS. I was going to ask that next. but go ahead. Professor Heller?

Mr. HELLER. Just for the record, I think I suggested that if the choice were between a higher, more adequate defense budget and a continuation of the deficit into fiscal 1960, I would prefer that continuation of the deficit. This choice is reinforced by the fact that there is a lot of slack left in the economy. I don't feel that we will be facing a critical inflationary problem during the next 12 to 18 months.

Representative CURTIS. Is there any other member of the panel who wants to comment?

Mr. RATCHFORD. I didn't express myself particularly on that point, but I think I would go along with Professor Samuelson. I think there will be a deficit. Just how large I don't know and would not be concerned about it unless there is a strong inflationary trend.

Representative CURTIS. Professor Fellner?

Mr. FELLNER. I would be in favor of balancing the budget at that level of activity at which we do not want to provide a further stimulus by budgetary devices, deficits. My guess would be that we will reach this level of activity in 1959–60.

If we don't reach it, then the budget will not be balanced anyway.

As Mr. Samuelson said, in that case we should nevertheless go on as projected with present expenditure plans. Disregarding a rise in the defense budget, which I think would call for a tax increase, I would just keep taxes where they are and then let things happen.

Representative CURTIS. I should interpose, of course, the present budget is based on the premise that there is going to be recovery. That is agreed, I think. So it comes to the next question, which, of course, is a very basic one, of whether or not the budget atcually proposed is balanced, because one of the questions we have here is, What, if any, changes in the Government economic policies are called for in the year ahead?

Would it be fair to say this, that on the assumption that the economy does recover as contemplated in the President's budget, no one would recommend a deficit financing? Is that fair or am I still going beyond some of your thinking?

Mr. Fellner. No. I would agree.

Mr. Ratchford. Yes.

Mr. Samuelson. I am not sure. As I remember it, the revenue estimates of the Government are for about $48 billion of corporate profits.

Mr. Stein. $47 billion.

Mr. Samuelson. And I have seen informal—allegedly, Department of Commerce—estimates that in the fourth quarter of 1958 there were $45 billion. So it would look as if $47 billion is well within the realm of possibility.

I am not sure whether that degree of recovery corresponds to a rate of unemployment of below 4 percent. It may well correspond to a rate of unemployment of 4½ to 5½ percent.

Representative Curtis. So your decision would be, in answering my question, that you would be watching for the unemployment rate, and you would figure that that factor might cause you to exercise a caution where you would say that you might go along with that?

Mr. Samuelson. That would be one of the key variables I would watch in trying to decide whether the budget deficit was too large or insufficiently large.

Mr. Stein. There is one thing very difficult to figure but which should be considered. The 1959–60 budget is balanced in part by virtue of certain financial transactions, by sale of certain assets held by the Government, FNMA mortgages and so forth. So I think it is true that this balanced budget is less inflationary than some other balanced budgets we have had in other years, and this, in my mind, is one reason for trying to get a surplus in a budget that is so balanced and so defined.

Representative Curtis. That was one of the questions I had in mind. The second really was, after getting over the question of whether anyone in the panel would recommend a deficit of financing on the assumption that we do have the economic recovery we are talking about, whether anyone on the panel would recommend that we should be paying off on the Federal debt or have an item in the budget for that.

I presume that you would, Mr. Stein.

Mr. Stein. I have recommended that; yes.

Representative Curtis. Of those who wouldn't I would like to ask this question:

In previous discussions of deficit financing, as I have understood the hypothesis, it was on the assumption that you would afford deficit financing because you would recoup and pay off in prosperous years. If anyone adheres to that theory, just how do you reconcile a situation where we contemplate prosperous years in 1959 on into 1960 with, first, limiting deficit financing, and, second, actually following out Dr. Stein's suggestion that we pay off on the debt? Would anyone like to comment on that?

Dr. Heller?

Mr. Heller. On this point I think we are in agreement, that when the economy reaches a tight situation, when inflation is a problem, by all means let's obtain a surplus and maintain a surplus. I think both Professor Musgrave and I criticized the Economic Report for holding out the hope of tax reductions as soon as we developed a surplus. That seems to me precisely the wrong policy.

Representative CURTIS. So, to get this straight, in other words you are saying that instead of a tax reduction, that money should be used to pay on the debt. Is that right?

Mr. HELLER. Yes, indeed; in order to abate the inflationary pressures that will develop at that time.

I think our main difference is the point at which we would visualize the necessity for an anti-inflationary surplus, the point in time. I don't think there is any disagreement on the fundamental approach to the policy, however.

Mr. MUSGRAVE. I think this is quite correct. I might only add that if economists say that you should incur a deficit in a depression and should incur a surplus in a boom, this is contingent that the economic circumstances which require this deficit or this surplus do actually arise. In other words, we don't say that we should have a deficit in the depression because we are sure that we can pay off in the boom. We say we should have a deficit in the depression while it is needed in the depression, and then have a surplus in the boom while it is needed in the boom. Whether these two things just cancel out or not depends on economic circumstances.

As Professor Samuelson points out, the level of interest rates, while subject to Federal Reserve control, is a part of stabilization policy and cannot be singled out. A very easy-money policy will call for a very tight fiscal policy and vice versa. However, the other part of Congressman Patman's question is a different matter: There is no necessity that all increases in the level of interest rates must be transmitted fully into higher interest cost on the public debt. Arrangements may be made to avoid this. Thus, debt may be sold to the Federal Reserve at no interest cost, and reserve requirements may be raised to offset the gain in excess reserves; or, which is much the same, commercial banks may be asked to hold secondary reserves in the form of low (or zero) yielding Treasury obligations. Similar requirements might be applied to institutional lenders.

Such structural changes may be made, while retaining the stabilization function of a tight-money policy. Whether they should be made, is a different matter. It depends on one's appraisal of the earnings of financial institutions, and on who should pay for their services. Thus, if banks obtain less earnings from Government securities, they may have to supplement their earnings by higher customer charges, thereby raising the cost of doing business and transmitting the charges to the final consumer. However this may be, the case for permitting flexible interest rates does not necessarily demand that the entire weight of higher rates must be reflected in higher charges on the entire public debt.

Would you permit me to add a very brief word on the point Mr. Patman raised? Or could this be done later?

Representative CURTIS. If you will come back to that later, I would like to have you do so. But I would like to follow through this one thought I have right now.

It strikes me that the keystone of the President's economic policy for the next 2 years is a balanced budget. One of the questions that has been directed to the panel is: What, if any, changes in governmental economic policies are called for in the year ahead?

Would any of the panel take exception, or have you taken exception to this as a keystone for the economic policies for the next 2 years ahead for the Federal Government? That is, an attempt to have a balanced budget?

Mr. HELLER. Well, in all candor, I must say I have taken exception for the period immediately ahead. I think that the balanced budget objective has been given too high a priority.

Mr. STEIN. I would like to say something about Dr. Heller's use of the phrase "when inflation becomes a problem."

I think inflation is a problem now, and we don't have to wait for it to become a problem. But I think we have a question here of the definition of a problem, and I would like to revert to the situation last March and April when the chairman of this committee was recommending a tax reduction and I agreed with him.

This recommendation was not made on the basis that we were certain that the economy was going to go down into a deep depression. It was made, as I understand it, on the basis that we were then in a situation in which we had about 7½ percent of the labor force unemployed and, while there was a possibility that we would go up, there was also a possibility that we would go down, and the danger that we would go down was much more serious. That is, this would be a much more serious outcome if it developed, and therefore it was necessary to take some insurance against it.

I agreed with that logic then, and I feel that the same logic applies now with respect to the inflation problem. I think we are now in the position where we may either go up at a relatively mild rate without inflation, or the alternative is that we initiate another boom like the 1955–56 boom in which we will have a resumption of fairly vigorous inflation. That seems to me, starting from where we now stand and with the prospect we now have before us, the more dangerous evil and, therefore, the one most to be guarded against, just as last year the more dangerous evil and the one most to be guarded against was further decline of the economy.

So these are all probability problems. Nobody can tell you certainly what will happen or what is the best solution. He can tell you there is a range of possibilities, and perhaps you can extract which would be the most dangerous if it occurred, and be guided accordingly.

Representative CURTIS. My time has expired, Mr. Chairman.

The CHAIRMAN. Mr. Bolling.

Representative BOLLING. Mr. Chairman, I would like to get an expression of opinion from each of the panel on this question:

Would Federal economic policies in 1959, designed to stimulate vigorous growth and productive capacity and demand, carry a serious threat of inflation? And by "vigorous" I mean something quite substantial, on the order of—since we are coming out of a recession and last year had a negative situation rather than an increase—something on the order of 8 or 10 percent increase in taxes.

Mr. MUSGRAVE. I am not quite sure I understand the question.

Representative BOLLING. Would Federal economic policies in 1959, designed to stimulate vigorous growth in productive capacity and demand, carry a serious threat of inflation in 1959?

Mr. MUSGRAVE. Well, you have got to have a Federal economic policy that stimulates growth, and you may find that such a policy will produce an inflationary tendency, in which case I would agree with what Mr. Heller said, or I guess Mr. Samuelson, that you have to run the risk on the inflationary threat and hope to do something about it but, in any case, you have to try to stimulate growth.

I would say that we are as yet in a position where we might expect that such stimulation would be directed at taking up some of the slack in the economic system which still exists. In other words, let's go ahead and do the stimulating and deal with the inflation problem if it arises.

Representative BOLLING. That is the point I would like to be sure I understand.

You feel that we have to try to stimulate the growth, but you are not sure that those policies to stimulate growth would then result in immediate inflation? This is where you begin your qualification?

Mr. MUSGRAVE. I doubt that it would result in immediate inflation.

Representative BOLLING. Now I would like to go around the table to this——

Mr. FELLNER. I believe that the growth which is now in prospect, this expansion, is very unlikely to lead to demand inflation. Whether it is not going to lead to cost-push inflation in 1959 is unpredictable. We will have to do our best to keep that within bounds or suppress it as well as we can, but I think we should take our chances in aiming for this GNP of a little over $480 billion for fiscal 1960. I don't think there will be any demand inflation, and the risk of cost-push inflation is unfortunately here. But I think it is something we have to face whenever it develops and see what we can do about it at the prospective level of activity.

Mr. HELLER. This is the kind of a question that is very difficult not to be misunderstood on, and I would like to put my position on it this way, that insofar as inflation has been made the transcendent problem to which all policies in the Economic Report seem to be oriented, I think the report is wrong. I think that our transcendent problem is to have a Defense Establishment and a rate of economic growth which will enable us to maintain our position of leadership and, for that matter, of survival in this cold war world. Those should be our first emphases.

I don't like to see them undercut because of an excessive concern with the inflation problem. I don't feel that inflation is an immediate problem in the sense that we have substantial slack in our economy and that the productivity of our economy is increasing rapidly during economic recovery.

My essential point then is one of priorities. Let's take the measures to get growth. Let's invest in education and scientific research and so forth. Let's get a Defense Establishment that will restore our position. Let's get an investment in space exploration. Then, if there is an inflation problem, by all means raise taxes and take the other necessary measures to curtail inflation.

Mr. RATCHFORD. I think my position would be this:

As I stated, we now have a very strong recovery underway. I believe that the recovery will go ahead without additional stimulation from Government expenditures to give us something like the levels that have been forecast, although I recognize the possibility of unforeseen developments.

If that is true, I would think that a substantial increase in Federal expenditures, say on the order of $5 billion, if that were not counteracted by additional taxes, would bring us rather quickly a serious inflationary threat.

Mr. SAMUELSON. I would like to direct my remarks to the precise question asked. I don't feel happy in giving my answer, but I am just calling my shots as I see them.

I think that we are in a fairly vigorous expansion. It probably by itself would not within a year or so produce unemployment to the low levels that I would hope would be our long-term goals. I think if, on top of this, one were to add a militant government expansionary program, to wipe out the unemployment faster than it is going to be wiped out, some risk would be run that the principal indexes of prices—this is the way I would measure inflation, not as a danger in some expert's mind but as something that is recorded in the price indexes—that you do run a risk of adding to the upward price march.

Mr. STEIN. I think that we will probably have the 6 to 8 percent increase in total production that Congressman Bolling talked about without further stimulus from the Federal Government. I am talking about change from the fourth quarter of 1958 to the fourth quarter of 1959. Six percent increase would bring the gross national product in the fourth quarter of 1959 up to about $485 billion. Eight percent would be, say, $495. I think that without further stimulus we will be in that range.

I would say further that I am not a worshiper at the altar of growth. It does not seem to me to be one of our great problems, whether the gross national product of this country in 1980 is $1,000 billion or $1,200 billion. I think we have many more serious problems than that, and I would rate inflation among them.

I think that further stimulus from the Federal Government would not create the problem of inflation, because I think the problem exists. I think it would certainly intensify it.

With respect to Dr. Samuelson's remark about what is in my mind, of course what is in my mind is the thought that further movement of these price indexes, to which I would also look, would solidify in this country the tendency toward an autonomous inflationary march, toward a pattern of expectation of annual wage increases, in excess of productivity gains, on the part of both organized and unorganized workers, and toward the expectation on the part of business that they can also without penalty raise prices. Then we will have a situation, I fear, in which we cannot retreat and cannot put on the brakes by monetary and fiscal means.

So, I would like to put on the brakes now before we create this situation or make it even stronger than I fear it may be.

The CHAIRMAN. Congressman Kilburn.

Representative KILBURN. I was interested when Professor Heller, I think, and maybe one or two others made a statement, as I understood it, that we should spend more for national defense. Of course, I always considered that we want an absolutely perfect national defense in any eventuality, surprise attack or anything else. But it does seem to me that national defense is something like trying to cure cancer. You can't do it just by appropriating money. It has got to be set up in the right way. And under our Constitution, the President, as the Commander in Chief, and his staff probably get more information than anyone else, and are the best judges of just how we set up our national defense.

I would presume, sir, that you would agree that if we did have a perfect national defense against any eventuality, you wouldn't want to spend any more money than that. I think we would all agree on that.

The question that I would like to ask is this:

Do you believe that the President and the Joint Chiefs of Staff and all the people interested in defense who know—presumably have got more information than anyone else in this country—are the proper ones to judge whether or not we have got an adequate national defense?

Mr. FELLNER. Mr. Chairman, in my testimony I said that obviously people who are inexpert in judging military affairs should not develop very categoric views about a problem of this sort. But I think I should say, in all frankness, that the testimonies that were published, testimonies given before the Armed Services Committee of the Senate, did raise question marks in my mind, and I think in the minds of most readers, with respect to the question of whether we are really spending on defense all we should.

Representative KILBURN. Of course, I don't think there is any question but that there are differences of opinion. I agree to that. And everybody is entitled to an opinion, naturally. But I do feel that the responsibility in the Constitution being where it is, and due to the fact that they have more information probably than I expect any of these people who testified have, I would be inclined to go along with their judgment on the matter.

Mr. FELLNER. But by the people who have testified I mean partly the Joint Chiefs themselves, who really added a number of qualifications to the statement that we are adequately equipped, and rather important qualifications, I felt just as a reader of the newspapers.

Representative KILBURN. Does someone else want to comment?

Mr. HELLER. Just one comment. Those who do not have a personal or organizational stake in defending the adequacy of our present defense policy and yet have taken a very close look at it, like the Gaither group, like the Rockefeller report, like General Gavin, seem to take a very different point of view than that which we are given by the President and sometimes by the Joint Chiefs. This is, needless to say, what causes apprehension about our position in military preparedness, progress in the space race and so forth, and which leads one to say that budgetary considerations and misplaced fears of breakdown in the economy should not be permitted to deny this country the Defense Establishment it needs in this critical situation. Similarly, we should not permit an artifical barrier like the Federal debt limit to force unwise cutbacks or place an arbitrary ceiling on defense outlays, as it is acknowledged to have done in 1957.

(Mr. Heller supplied additional material on the debt limit and its impact, see p. 230).

Representative KILBURN. Just on that one little point:

Of course, with the expense involved in national defense now, the astronomical cost of different weapons that we have a breakdown in our economy would ruin our defense, it seems to me.

Mr. HELLER. Yes, but I think that the consensus here is that no breakdown is in sight even with heavier demands for military expenditures.

Mr. SAMUELSON. I think there is one aspect of this matter that a political economist can with some authority speak to. Clemenceau said that war was too important to leave to generals. I will not bring up that remark, but I think that political economy is too important to leave to nonpolitical economists.

The CHAIRMAN. Do you mean it is too important to leave to economists?

Mr. SAMUELSON. No. Political economy is too important to leave to nonpolitical economists.

Representative KILBURN. That is just the reverse of that.

Mr. SAMUELSON. Yes. I am improving on the remark. If the President said, "Without regard to the burden which will be put upon the economy, I have contemplated the defense expenditure and have set it at this prudent magnitude, period," political economists and a mere amateur would have little to say. But that is not the way the President has spoken in the last years, or the Secretary of the Treasury, or the Bureau of the Budget. They have spoken in terms of what the economy can afford, of a nice check and balance between the requirements of defense and the harm done to the economy.

I think it is to that aspect of the problem that all of us here have directed our remarks, and we all have been very critical. We do not find a crisis beyond which one pfennig of expenditure will send us into disaster. On the contrary, if the generals tell us that they can use more in this all-important race, we say that the economy can take it, and you gentlemen will have to pass the legislation which will accommodate that extra burden without undue inflation and disorganization, with our advice as to how to do it.

Representative KILBURN. Perhaps we had better put some political economists on the general staff.

Representative CURTIS. It would be a good idea.

Representative KILBURN. That is all, Mr. Chairman.

The CHAIRMAN. Mr. Widnall.

Representative WIDNALL. Don't you feel, in view of the fact that we probably have an unbalanced budget already, that if there is to be further deficit spending priorities ought to be developed as to that spending? For instance, the emphasis right now has been on increased spending on the national defense. If we take that as the first item of expenditure, where do you think the other priorities lie, for consideration by the Congress, because we cannot go overboard in every direction at once? That is a difficult question. We have to solve this ourselves when we are voting on these measures.

Mr. HELLER. Do you want an expression of our prejudices in that matter?

The CHAIRMAN. I think I may say we are waiting with great anxiety for your replies because this is the essence of the decisions we have got to make in the coming months. We tried to get some information on this yesterday, and got no advice. So I am very glad Mr. Widnall has raised this point.

Mr. HELLER. At the risk of seeming like a party at interest, I should say the second priority should go to an investment in education and research, assuming that foreign aid is considered part of the overall national security expenditure, which is given first priority.

Again following Mr. Kilburn's line, the line of his original question, I would say a great deal can be done in the field of education to improve the efficiency of the current expenditures, just as in the military side of it, but that fundamentally and in the last analysis the problem does come down to adequate financing.

It is high time for us to think not only in the traditional sense of education, as an end in itself, as we must do, in terms of human fulfillment, but in terms of the tremendous gains to be reaped in expanding brain capacity side by side with plant capacity.

As far as the Federal Government is concerned, it is high time for the Federal Government to recognize its direct responsibility more adequately in achieving its economic growth and national defense objectives by investing in education through Federal aid.

Next to that, I would urge a much more effective program to meet the problems of the metropolitan areas, the slum clearance problem, the tremendous urban transit problem. In our State legislatures, the rural areas are overrepresented. I don't know how we are going to solve the problem of the rotten core of the cities without additional Federal aid. I know that the people in the field of urban transit, including the people in the private industry end of this, are now pressing Congress to provide some additional funds along these lines.

I might say that this same argument argues very strongly against pressing Federal functions back onto the States when they already are bearing a good deal more pressure than the Federal Government in civilian expenses. If you would look at the States you will see that State and local spending has risen by 50 percent in the last 4 or 5 fiscal years as against a rise of about one-third to one-fourth as much in Federal spending.

So I would put some consideration for State-local problems very high on the priority list if this Federal budget were to be expanded.

Representative WIDNALL. Hasn't a great deal of that spending on the State and local level been in the cause of education?

Mr. HELLER. Yes, it has. Thirty-six percent of State and local spending is in the educational field. And there has been a great increase in such spending, but not nearly enough in terms of what the Nation has to gain from educational investment.

Representative WIDNALL. Where do you place housing in the category of priorities?

Mr. HELLER. I wonder whether I shouldn't give someone else a chance. I don't want to duck this, but I don't want to monopolize this question either.

Mr. STEIN. I am afraid we are not helping Mr. Widnall because I understood his problem was where not to expand rather than where to expand. We can all give him a lot of places to expand.

In establishing an order of priorities I would put the national defense first, foreign economic assistance second, and then I would have nothing, nothing, nothing, and then begin to come down to other things which seem to me much less important.

It seems to me we could perhaps be most helpful by starting at the other end and saying what is at the bottom of the priority list.

I would personally hope that we could do something about our enormous expenditure for agricultural support. I was very much impressed by the message the President sent up yesterday, and was impressed with this problem earlier. It seems to me it is the one largest chunk in which some reduction can be made. I feel that with any reasonable program, to make the reduction is going to take a long time, but unless we start this transition we will never get there.

Mr. FELLNER. I would like to say that this, of course, is a matter of value judgments, and people have different lists of priorities. But if I may express my own feeling about this, then I would not raise taxes in order to raise these nondefense expenditures at a more rapid rate than they are raising—Federal expenditures I mean. After all, if they will rise gradually more or less in proportion to general growth rates then the rising needs of this sort can be satisfied to a reasonable extent without raising tax rates. So I would not consider raising tax rates in order to raise these Federal nondefense expenditures at a more rapid rate.

But with defense I would certainly make an exception. And the situation is quite different for defense expenditures also, because they have been kept constant over the past few years, in real terms, in spite of a gradual rise in the GNP, while the other expenditures have been rising; as a matter of fact, rising at a somewhat more rapid rate than the GNP.

Mr. MUSGRAVE. I would pretty much accept Dr. Stein's list of priorities, certainly begin with national defense and foreign economic aid, which, of course, is part of the same general complex of problems. I would then add education; quite strongly, yet with a certain "but" attached to it, namely, if the Federal Government aids education as it should, let it not be biased by the belief that spending on buildings is investment and spending on teachers is current outlays. I would rate spending on school buildings down with housing, and spending on investment in human resources in education right after foreign economic aid.

My second "but", with regard to education, is that I see the Federal function in education to be primarily a redistribution from rich to poor areas in this country, rather than a general support of education. At the State level, it is very much more difficult for the poor States to do the minimum job in education which needs to be done.

Not everybody is going to gain by Federal aid to education. I think it has to be a transfer from the wealthy to the poor areas.

The areas where savings might be made are, as has been mentioned—agriculture and, I would also say, highway expenditures. This is another instance where the opportunity for some special budgetary arrangement, which seems to take care of things, gets us off into a big expenditure program which has much lower priority in terms of national needs than other things for which you cannot raise the revenue. I would quite gladly do away with the highway program and the highway fund and use those funds to spend on human resources in education.

Representative WIDNALL. I believe my time is up. Thank you.

The CHAIRMAN. We have 5 minutes more before 12 o'clock. I would suggest that if Mr. Bolling and Mr. Curtis wish to make any statements, they divide the time equally between them. Or, if you wish to, ask any questions which can be answered in 2½ minutes.

Mr. BOLLING. This could go on for an hour or could take 2 minutes, but I would like to get very quick comments from the panel on the President's recommendations for promoting economic growth. They appear on page 67 and following.

The CHAIRMAN. I will be accused by my Republican colleagues of injecting a note of humor into the proceedings, but I would like to ask how significant you regard this recommendation for economic growth on page 68, Subitem I, "enact a long-range program to conserve helium gas."

Representative CURTIS. It is a pretty important program. It really is.

The CHAIRMAN. Go ahead.

Representative BOLLING. Aside from item H, how much growth does the panel think that this program will induce?

Mr. STEIN. I would say it is very little, although I think they are good recommendations. I don't think they really make the difference between 3 percent and 3.05 percent rate of growth. But I think that is also true, I must hasten to add, about almost all other suggestions I have heard about promoting economic growth in the United States. That is, I think we have never faced up to what is involved in raising a 3 percent growth rate to 4 percent. This is an increase of one-third; it is an increase of one-half, say, in the output per worker, and it seems to me just offhand this involves something like an increase of one-half in the rate of physical investment in research, in education, et cetera, and this gets you up into tremendous amounts of money, like $50 to $60 billion a year. This is one of the reasons why I am not one of the new 5-percenters who think that there is some easy route to getting what has for a long time been 3 percent up to 5 percent.

The CHAIRMAN. Mr. Curtis, do you want to speak?

Representative CURTIS. No. I think there are others who would like to comment.

Representative BOLLING. Will you yield your 2½ minutes.

Representative CURTIS. Sure I will yield my 2½ minutes.

Representative BOLLING. Are there any other comments? Do I get a ghastly silence from the other five?

Mr. HELLER. I will only repeat what I said earlier. If we are looking toward longer-run growth, a larger investment in the human resources of which Dr. Musgrave spoke, in the form of expanded basic research, in the form of improved education and so forth——

Representative BOLLING. I gather by what you are saying you don't find that in the President's report.

Mr. HELLER. No, I don't find those here at all.

There is some talk about doubling or tripling the appropriation for the National Science Foundation, but when you are doubling or tripling $20 million or whatever it is, it amounts to very little indeed.

So I think that totally inadequate provision is made for this aspect of long-term growth and, particularly, long-term growth that can lead to a great increase in human well-being itself.

Mr. FELLNER. I will say this quite briefly. I think that the reason why growth rates were unsatisfactory over the last few years has a lot to do with the fact that an acute inflation problem developed, and that the authorities were fighting this inflation problem, and if we now could come out of this recession with this appreciable expansion rate and then aim at the level of activity at which such inflationary pressures won't be renewed, then I see no reason why we should not get up to the growth rates that we observed prior to, I would say, 1955. So we will have, I think, a substantial expansion rate in the next year, an expansion rate that will correspond perhaps to a yearly growth rate of about 3 percent from 1957 to 1959 in spite of the intervening recession. And from there on, if we can avoid sharp cyclical setbacks due to a rather acute inflation problem, then I think growth rates will keep up without any further major change.

Mr. MUSGRAVE. I would only add that there should not be exclusive concern with the growth rate. The structure of growth which you are going to have in the short run has a lot to do with the growth which you are going to have in the long run. And, in terms of the overall world picture, it is the long-run growth that matters. It is not of vital national importance whether tail fins have grown and the prices of automobiles have increased accordingly. This takes us again back to the problem of investment in human resources, investment in the basic capacity of the economy to grow over an extended period. There should be more emphasis on the structure of growth and less on the growth rate.

The CHAIRMAN. Unless anyone else is moved to speak, we will thank you gentlemen for coming.

And the next session of the committee will be on Monday at 10 o'clock, in room 457, in the Senate Office Building.

(Mr. Heller subsequently submitted the following for the record:)

### WHY A FEDERAL DEBT LIMIT?

By Walter W. Heller, chairman, department of economics, University of Minnesota, before the 51st Annual Conference of Taxation of the National Tax Association, October 28, 1958

The position taken in this paper can be briefly put by amending the title to read, "Why a Federal Debt Limit, Indeed?" Far from promoting fiscal prudence and expenditure restraint, as claimed by its protagonists the Federal debt limit has in fact eroded the integrity of our Federal budget, interfered with efficient expenditure scheduling and effective debt management, endangered our defense program, and aggravated the 1957–58 recession. The facts and analysis underlying each of these indictments form the core of my paper.

No attempt will be made here to trace the history of the debt limit, nor to identify the half billion dollars of public debt obligations not subject to the limit. The testimony of Treasury Secretary Anderson before the Ways and Means Committee last January contains a most useful historical survey of, and commentary on, the debt limit.[1] An annual summary of the basic data and history of the debt limit is contained in the annual reports of the Secretary of the Treasury.[2] A monthly release summarizing the status of the debt is issued by the Treasury Department Fiscal Service. The latest one, for example, shows a margin of roughly $12 billion between the outstanding debt on September 30 of $276.4 billion and the limit of $288 billion (consisting of the perma-

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[1] Statement by Treasury Secretary Anderson before House Ways and Means Committee on H.R. 9955 and H.R. 9956, bills to amend the Statutory Debt Limitation, Jan. 17, 1958, U.S. Treasury Release No. A–138.

[2] See, for example, the Annual Report of the Secretary of the Treasury on the State of the Finances, fiscal year 1957, U.S. Government Printing Office, Washington, 1958, tables 26 and 27, pp. 432–433. These tables show the fiscal yearend status of the debt under the limit and the history of the debt limit since 1941. Monthly summaries are presented in the Treasury Bulletin. The pre-1941 history is summarized in the Treasury's Annual report, fiscal year 1940, p. 70.

nent limit of $283 billion, as amended September 2, 1958, and a temporary additional $5 billion, expiring June 30, 1959).[3]

A. EROSION OF BUDGETARY INTEGRITY

One of the most serious charges against the debt ceiling is that it has served as stimulus and sanction for devious budget practices and proposals. Quite apart from the costly defense slowdowns last year, which have been very much in the public eye, the ceiling has been a major factor in prompting (1) manipulations to remove certain spending items from the budget entirely (e.g., in 1953, $1.2 billion of price support loans), (2) proposals in 1955 for highway financing outside the conventional budget and outside the debt limit, and (3) substitution in 1957 of costly agency borrowing for cheaper Treasury borrowing.

Under the impact of the large deficit in fiscal 1953, compounded by the sparse receipts typical of the July–December half of each fiscal year (when only 40 percent of the year's receipts typically flow into the Treasury), the pressure of the debt limit mounted steadily. By August 1953, Treasury Secretary Humphrey was moved to say, "The present debt limit severely restricts flexibility and will more and more limit our ability to administer the financial affairs of the Government."[4] Simultaneously, the fiscal authorities found an escape valve that has been utilized many times since, namely, requesting Federal agencies to finance themselves by direct operations in the money market rather than through Treasury borrowings. The Commodity Credit Corporation led the way by selling $1.2 billion of certificates of interest to the commercial banks during the second half of 1953 against a nationwide pool of price support loans on grain. This amount stayed out of the national debt and the nearly $1 billion still outstanding on June 30 quietly disappeared from the fiscal 1954 Federal budget.[5]

When the rest of the 1953 support loans matured in 1954, bringing much of this amount back onto the budget, a roughly equivalent amount was similarly financed the following summer. When this phase of off-the-budget financing was terminated in fiscal 1955 by retiring about half a billion dollars of certificates still outstanding, the Federal National Mortgage Association (FNMA) issued an offsetting amount of notes directly to the public. The collateral in this case was not farm crops bot the FNMA mortgage portfolio. In both cases, interest costs were substantially higher than on direct Treasury obligations.

In 1955, a related fiscal maneuver in connection with the Federal highway program never got beyond the proposal stage because of a storm of congressional protest. The proposal was that an independent authority be set up to finance the program by the issuance of general revenue bonds to be repaid out of the growth of Federal revenues from excise taxes on gasoline and lubricating oils.[6] There was bitter objection to thus circumventing the debt limit and hiding the expenditures from ordinary budget view. As finally passed, the program provided for increased highway user taxes, earmarked for highway purposes and channeled through a special trust fund.

One does not have to go back to 1953 and 1955 for examples of evasive action and financial brinkmanship under the debt ceiling. The Treasury's greatest hour of jeopardy to date under the ceiling was in 1957. No halfback threading his way precariously down the sidelines ever executed more nimble maneuvers than the Federal fiscal authorities did to keep from going out of bounds during

[3] Treasury Department Fiscal Service, "Statutory Debt Limitation as of Sept. 30, 1958," release No. A–341, Washington, Oct. 9, 1958. The two controlling laws at the present time are the act of Sept. 2, 1958; U.S.C., title 31, sec. 757b, and the act of Feb. 26, 1958; Public Law 85–336, 85th Cong.

[4] Treasury Department release, Aug. 3, 1953 (H–211).

[5] The Treasury noted that this financial maneuver "increased the participation by banks in the crop loan program and gave temporary assistance to the Treasury in staying below the statutory debt limitation." U.S. Treasury annual report, fiscal year 1954. Pressure on the budget and the public debt was also diminished by "the Federal National Mortgage Association's accelerated program of mortgage sales and repayment of advances by local housing authorities to the Public Housing Administration." Ibid. For a more detailed explanation of the maneuvers to minimize the budget totals in 1953–54, see Frederick C. Dirks, "Recent Progress in the Federal Budget," National Tax Journal, June 1954, vol. VII, No. 2, pp. 141–154.

[6] House of Representatives, Committee on Public Works, "Hearings on National Highway Program," 1955, p. 130. For the detailed proposals and the criticisms directed at them, see these hearings as well as the corresponding hearings before the Senate subcommittee of the Committee on Public Works, also in 1955.

the past fiscal year.[7] In order to help keep the debt under the limit in 1957–58, various agencies, particularly the Federal National Mortgage Association, borrowed funds from the public to permit repayment to the Treasury of sums which had been advanced to them. About $1.5 billion of such repayments were made by the Federal National Mortgage Association from February 1957 to March 1958.[8] Coupled with these moves were slowdowns of defense programs and payments (to be examined in section C) and monetization of some of the Treasury's gold.[9]

The debt limit, then, has served as an ethical shield behind which assaults have been made on the fidelity of our Federal budget. I put it this way because some of the manipulative practices described above were attractive in serving quite a different purpose; namely, to make the budget look smaller than it really was—sort of an incredible shrinking budget—but they might not have been dared without the protective casuistry of the debt ceiling.

### B. SELF-DEFEATING EXPENDITURE CONTROL

Defenders of the statutory debt limit usually cite its salutary effect in curbing Federal spending. For example, in the hearings on the debt limit last January, Senator Harry Byrd asserted, "The only protection Congress and the people have against wasteful expenditures is the debt limit." Prof. Yale Brozen, of Chicago, came to its defense in a similar vein during a panel discussion before the Joint Economic Committee last February. Prof. Lester Chandler of Princeton had proposed "that they should abolish the debt limit or raise it so much that this would become ineffective as a ceiling," a position quickly concurred in by Prof. J. Kenneth Galbraith of Harvard, Mr. Ralph J. Watkins, director of economic studies of the Brookings Institution, and Prof. Roy Blough of Columbia. Mr. Brozen disagreed, stating "I think to some extent there has been a salutary effect from the existence of the debt ceiling inasmuch as the administration does tend to think a little more seriously about its overall spending program." [10]

The expenditure restraint which these statements contemplate typically has two facets. One is economizing, i.e., eliminating waste and thereby providing a given service with a smaller input of money and resources. The other is simply the curbing of growth or forcing of cutbacks in Government spending when deficits threaten to push the debt through the legal ceiling.

On the first score, the record of the debt ceiling is lamentable. It has forced Government borrowing into uneconomic, expensive channels. The $802 million FNMA notes sold outside the debt limit a year ago are a perfect case in point. That they were sold at the Treasury's request in the context of the painful debt squeeze is beyond dispute.[11] That they were costly is also beyond question. Maturing in only 8 months, the notes carried an interest rate of 4⅞ percent, when the Treasury could have borrowed the money directly at 4 percent.[12] In

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[7] The following item from the Wall Street Journal, Sept. 27, 1957, p. 1, vividly brings out the mood of the time and the measures that were contemplated to meet the debt ceiling crisis: "Fiscal chiefs struggle to stay under the debt limit. They seize on new tactics. Defense officials postpone every postponable spending item beyond the critical next few months. They confer with major contractors on delaying payments. Less urgent operating, maintenance outlays will wait till after January. The Budget Bureau holds back funds to keep other agencies from expanding employment as much as Congress allowed, at least for now. Other weapons are in reserve. Farm officials consider selling private banks certificates representing shares in a pool of price-support loans; the cash would ease the current squeeze. The Federal National Mortgage Association can sell more securities privately, pay off some debt owed the Treasury. Money men talk of last-ditch moves if the scrape with the debt ceiling gets desperate. Defense officials say they could stop paying all bills until January tax receipts roll in."

[8] The First Boston Corp., "Securities of the U.S. Government, 18th ed., 1958, Boston," pp. 40–41. This publication also summarizes the history of debt limit legislation from 1917 to 1958 and charts the relationship between the debt and the legal limit for the fiscal years 1954–59.

[9] Monetization is effected by converting the free gold in the Treasury's general fund into gold certificates for deposit in Treasury balances in the Federal Reserve banks. By this method, $500 million of gold was monetized in November 1953, and another $100 million in February 1958. The process is described in detail in the Treasury's annual report, fiscal year 1954, p. 26.

[10] Joint Economic Committee, U.S. Congress, "Hearings, January 1958 Economic Report of the President," U.S. Government Printing Office, Washington, 1958, pp. 490–491.

[11] See, for example, the Business Week article, "Treasury's Eye Is On Ceiling," Nov. 2, 1957, p. 46.

[12] Outstanding Treasury notes maturing in June were yielding 3⅞ percent at the end of October 1957. Assuming that the Treasury would sweeten the yield a bit to gain market acceptance of a new issue, one arrives at a Treasury interest rate of 4 percent.

other words, a loss of $4,667,000 can be laid directly at the debt limit's door on account of this single evasive action.[13]

One cannot so readily put a price tag on the much greater waste attributable to the debt limit's disruptive affect on expenditure management and scheduling of particular programs. The force of the debt ceiling can strike swiftly, and to some extent, unexpectedly. Consider, for example, that Secretary Anderson's estimates last January (later revised) placed the prospective debt as of September 30, 1958, at $271.3 billion and the required debt limit at $274.3 billion. In fact, the debt was $276.4 billion on September 30. Even when the debt squeeze was anticipated in 1957, and advance action was taken to slow down expenditures, still further stretchout and pinchpenny economizing measures had to be taken when the squeeze turned out to be worse than expected. The resulting on-again, off-again scheduling of expenditures is just as wasteful of public moneys as stop-and-go driving is of gasoline.

As an overall curb on the growth of Government, the debt limit is even more inept and perverse in its impact. In a boom, when cutbacks might make some sense as an antiinflationary device, bulging revenues nullify any restraining effect. Thus, Federal cash expenditures rose from $70.5 billion in fiscal 1955 to $80 billion in fiscal 1957 at a time of little or no discomfort under the debt ceiling. It is at the onset of recession, as in the fall of 1953 and again in 1957, that the debt ceiling tightens its grip.

Does it then lead to rational choices among alternative programs, to a careful weighing of relative returns offered by different possible applications of resources? Quite the contrary. It seems to be a case of the devil, i.e., the debt ceiling, taking the hindmost. For example, when the psychological impact of the periodic debt limit wrangle hit Congress last July, the $2 billion community facilities bill bore part of the brunt, not necessarily because it was deemed a poor use of resources but because it happened to be under active consideration when the debt limit psychosis took hold.[14] This is budget pruning by the last-in, first-out principle.

But perhaps it is fruitless to ascribe to the debt ceiling any rigorous disciplinary logic at all. Perhaps it is more realistic to view it as an atavistic or nostalgic substitute for the annually balanced budget in the age-old battle between rules and authority, between laws and men, in Government budgeting. In this light, the debt limit is seen as a wistful vestige of the fiscal orthodoxy which, for example, led Franklin Roosevelt to drive income and excise tax increases through Congress in 1933 at the depths of the great depression in a quixotic attempt to carry out his campaign promise of a balanced budget.

Its kinship with the ill-fated legislative budget procedure (enacted in 1946) is even clearer. Under that procedure, Congress tried, unsuccessfully, to impose budgetary discipline on itself by requiring the enactment, early each session, of an overall ceiling on expenditure appropriations. But in the very first year of operation, the sum of the individual appropriations pierced the House ceiling by nearly $6 billion and the Senate ceiling by nearly $3 billion. In effect, the procedure foundered on our national schizophrenia in budget matters which leads us to recoil in dismay from the budget totals, even though they be no more than the sum of the parts we have warmly embraced one by one.

Failing in its attempt to curb its own spending tendencies with the aid of one rigid rule or another, the Congress has, ironically, used the debt ceiling to harass and castigate the executive authorities for the deficits which congressional budgetary enactments have forced them to incur. In this sense, the statutory limit has been an instrument of fiscal hypocrisy.

If the influence of the debt ceiling were benign, or at least negligible, we could afford to indulge ourselves in this hollow symbol of our budgetary schizophrenia. But the facts simply do not permit such tolerance. Last year's undercutting of defense in the very teeth of sputnik is a most telling case in point.

[13] In reporting plans for redeeming the FNMA 8-months notes, the Wall Street Journal on June 16, 1958, reported that the notes, which had been issued "at the request of the Treasury, when the Federal debt was close to the ceiling," would not be replaced with a new offering, thereby reflecting "the improved position of the Treasury since the new debt ceiling went into effect." The higher interest rate was also cited as a factor dictating against any refunding of the maturing notes. In other words, with the debt limit straitjacket loosened, the Treasury followed a course directly opposite to the one that had been forced on it by the debt ceiling squeeze in 1957

[14] Wall Street Journal, "Treasury Seeks Debt Ceiling Hike to $288 Billion," Aug. 25, 1958.

### C. THE NATIONAL DEFENSE CRISIS OF 1957

The operation of the debt ceiling "as a ruinous and arbitrary determinant of Government policies" is nowhere better illustrated than in last year's actions. "In the second half of 1957 the debt ceiling forced the administration to cut back programs needed for long-term national security. And the resulting slash in defense expenditures was an important contributing cause of the recession." [15]

A bill of particulars on the disruption of the defense program was summarized as follows a year ago: "Here are major Defense Department actions in recent months that are related to the campaign to save the debt ceiling: (1) The services stretched out production schedules for at least 19 big plane and missile projects, (2) overtime for defense contractors was restricted, (3) installment buying of weapons was banned, (4) a $38 billion spending ceiling for fiscal 1958 was clamped on, stimulating a new round of program reshuffling. From this action came the 5 percent reduction in progress payments; an order to contractors to cut payroll costs 5 percent; the Air Force's limitations on monthly payments to contractors, creating new stretchouts a 200,000-man cut in the Armed Forces." [16]

Apart from the dangerous 1957 slowdown itself, these actions have had lingering effects which have undermined the vigor of our response to the Soviet challenge. As the Wall Street Journal reported (July 8, 1958), "Because of the delayed-action effects of the Wilson economy slashes, spending actually dropped in the post-sputnik January-March quarter of this year to $9.4 billion, from $9.6 billion in the previous quarter." Even as late as May and July, 1958, defense contractors were expressing such apprehension of a repetition of the 1957 slowdown of payments and stretchouts in delivery schedules that the Secretary of Defense was moved to write a memorandum referring to "needless apprehension about a financial crisis." [17]

Thus far, the consequences of the 1957 cutbacks have been no more than dangerous for our national security. They could have been tragic.

### D. PERVERSE STABILIZATION EFFECTS

We have already noted the perversity of the debt limit in relation to inflation and recession. Its discipline on spending is little felt in the boom, but pinches hard in recession. The defense cutbacks to squeeze by under the ceiling are believed by many to have helped trigger the 1957–58 recession and increase its severity. As Ralph Watkins so forcefully put it: "* * * the crisis of confidence which shook American society last fall * * * may well have been precipitated by the cutbacks and stretchouts in military procurement starting in the summer. They affected a wide range of industry all across the country and, added to the impact of evidence of slow payment of bills by Government, could hardly fail to influence business confidence adversely. The real culprit, given our defense needs, may have been the arbitrary debt ceiling * * *. [18]

Apart from its direct impact in accelerating the 1957–58 recession, the debt ceiling has a more insidious indirect effect in that it condemns deficits without regard to economic circumstances. As long as there is substantial unemployment and idle plant capacity, deficits should be applauded as the hero of the peace, not hissed as the villain. They act as a constructive economic force, cushioning the shock of recession and stimulating production during the recovery phase. They become destructive only when the response to their expansionary impact is no longer rising employment and output, but rising prices, i.e., inflation. But the debt ceiling condemns all deficits alike, whether expansionary or inflationary.

Undoubtedly, the debt limit played a considerable role in restraining the administration and Congress from taking more resolute action to counter the recession in 1958. To be sure, it is a matter of open dispute whether the avoidance

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[15] Quotations are from a Business Week editorial, "Common Sense in Budgeting," June 28, 1958, p. 124.

[16] Business Week, "Treasury's Eye Is On Ceiling," Nov. 2, 1957, p. 47. The various moves are also described in Editorial Research Reports, under the heading, "Fiscal Maneuvers To Avoid Piercing Debt Ceiling" in its article, "National Debt Limit," Nov. 27, 1957, vol. II, pp. 879–80.

[17] As quoted in "Getting the Budget Back in Line," Business Week, July 12, 1958, p. 27. See also, "Arms Makers Fear Retrenchment," Business Week, May 31, 1958, pp. 21–22.

[18] Joint Economic Committee, "Hearings on the January 1958 Economic Report," op. cit., p. 467.

of tax cuts was economically a good or bad thing. It can be argued on one hand that we are enjoying a brisk recovery without tax reductions. It can be argued on the other that, with them, we might be farther along the path toward our full economic potential of $470–475 billion of gross national product against a current level approaching $450 billion. But even if the no-cut position could be proven correct, the debt limit would, at best, gain the distinction of being the wrong reason for reaching the right decision.

### E. RIGIDITY IN DEBT MANAGEMENT AND THINKING

The debt ceiling also inhibits stabilization policy by denying the Treasury the flexibility it needs to make full use of debt management, especially in strengthening our defenses against inflation. This point has been stressed again and again by Treasury officials in petitioning Congress for an increase in the statutory limit. As Secretary Anderson stated in his January testimony, "There is need for more flexibility for more efficient and economical management of the debt." He went on to say: "We have been able to discharge our obligation within the debt limit * * * only by maintaining cash balances which have been distressingly low at times. We have had little or no margin for contingencies. We believe that with some flexibility we would have been better able to manage the public debt to a better advantage for the public interest." [19]

With a higher debt ceiling, or in its absence, the Treasury would be able to build up a more comfortable cash balance when good opportunities presented themselves for marketing long-term debt. Long-term borrowing might be advantageous, for example, shortly in advance of a refunding operation. The net cash redemption, or "attrition," during the refunding could readily be handled out of the ample cash balance. Given the debt ceiling, however, the Treasury might run afoul of too little attrition, i.e., the refunded issue would overlap the newly issued long-terms, thereby piercing the ceiling. To avoid this contingency, the Treasury, in the shadow of the debt ceiling, would have to give up the opportunity to go into the long-term market and rely on bills instead.

Such rigidity in the short run is perhaps symptomatic of the patterns of thought that inhibit the all-out use of debt management as a stabilizing instrument. In this pattern, the debt ceiling assumes more the position of a limiting strategic factor than that of a basic cause.

If we are truly confronted with a complex of inflationary forces in the longer run, it is high time that we removed such shackles as the debt limit and permitted the Treasury, for example, to compete aggressively for long-term funds at the height of the boom and, if necessary, stockpile the proceeds in the Treasury cash balance. We need to reexamine the near axiom that the Treasury cannot borrow long in a boom because it would impinge unduly on sources of investment funds needed for private capital construction and State-local public works. Perhaps such borrowing, combined with stockpiling of the cash or retirement of bonds owned by the Federal Reserve banks, has advantages over traditional Federal Reserve measures to restrict the availability and raise the cost of credit. More freedom in shifting from one type of debt to another also merits further exploration. To clear the way for moving from a largely passive to an aggressively active debt-management policy would involve many things. One of them would be to abolish the debt limit.

### F. MEASURING DEBT BURDEN

This brief digression on unleashed debt management raises doubts that our statutory debt limit—insofar as it may be anything more than an empty gesture—is even cast in meaningful terms. As it stands, the debt limit perpetuates the myth that the overall dollar figure somehow represents the burden of the debt. But this figure bears little relationship to our fiscal capacity or to the burdensomeness of the debt.

Merely subtracting the debt held by government agencies gives us a more meaningful figure for most purposes. As part I of the accompanying table shows, the $270 billion of debt subject to the ceiling in mid-1957 shrinks to $215 billion if we exclude the holdings of government agencies and accounts and $192 billion if we eliminate the Federal Reserve holdings to arrive at privately held debt.

[19] Statement to the House Ways and Means Committee, Jan. 17, 1958, op. cit., pp. 1, 2.

To infuse greater significance into the debt figure, even if still in a rather passive sense, we need to relate it to some magnitude that measures or reflects our ability to carry the debt burden. Part II of the accompanying table shows that, as a proportion of annual national income, the Federal debt was cut in half, or more, between 1946 and 1957. Or relating the interest on the debt to national income, the burden has fallen by one-third.[20]

*The size of the Federal debt and interest, 1946–57 (a comparison of various measures)*

PT. I. DOLLAR AMOUNTS OF DEBT, CASH BALANCE, AND INTEREST

[In billions of dollars]

| Fiscal year [1] | Total outstanding debt | Total debt less debt held by Government accounts [2] | Privately held debt [3] | Treasury cash balance | Annual interest charge on total public debt |
|---|---|---|---|---|---|
| 1957 | 270.5 | 214.9 | 191.9 | 5.6 | 7.3 |
| 1956 | 272.8 | 219.3 | 195.5 | 6.0 | 7.0 |
| 1955 | 274.4 | 223.9 | 200.3 | 6.2 | 6.4 |
| 1954 | 271.3 | 221.9 | 196.9 | 6.8 | 6.3 |
| 1952 | 259.1 | 214.8 | 191.9 | 7.0 | 6.0 |
| 1950 | 257.4 | 219.5 | 201.2 | 5.5 | 5.6 |
| 1948 | 252.5 | 216.5 | 195.1 | 4.9 | 5.5 |
| 1946 | 269.4 | 240.3 | 216.5 | 14.2 | 5.4 |

PT. II. RATIO OF DEBT AND INTEREST TO NATIONAL INCOME [4]

| Fiscal year | Total debt as percent of national income | Total debt less debt held by Government accounts as percent of national income | Privately held debt as percent of national income | Interest on public debt as percent of national income |
|---|---|---|---|---|
| 1957 | 74 | 59 | 53 | 2.00 |
| 1956 | 78 | 63 | 56 | 1.99 |
| 1955 | 83 | 68 | 61 | 1.94 |
| 1954 | 90 | 74 | 65 | 2.09 |
| 1952 | 89 | 74 | 66 | 2.05 |
| 1950 | 106 | 91 | 83 | 2.31 |
| 1948 | 113 | 97 | 87 | 2.44 |
| 1946 | 149 | 133 | 120 | 2.96 |

[1] All debt and cash balance figures are shown as of June 30, the end of the fiscal year.
[2] "Government accounts" includes Government agencies and trust accounts.
[3] Excludes debt held by Federal Reserve banks as well as debt held by government accounts.
[4] These percentages relate June 30 debt totals and fiscal year interest charges to the calendar year national income.

Source: U.S. Treasury, Annual Report, fiscal year 1957, Washington, D.C., 1958. National income figures underlying pt. II were taken from U.S. Department of Commerce, "Survey of Current Business," July 1958.

Quite apart from these quantitive measurements, the real burden of the debt in a functional sense consists of its complication of inflation control, the possible unsettling effects of public debt transactions on the money markets, and the disincentive effects that may be involved in transferring funds from taxpayers to bondholders. Only a dynamic and continuous analysis of the debt, its composition, and its relation to economic conditions will serve as a basis for appraising its burden in this sense. Any single magnitude merely diverts attention from the intrinsic debt problem.

[20] Another approach to measuring the deadweight burden of the debt is suggested by James Buchanan in his new book, "Public Principles of Public Debt" (Richard D. Irwin, Homewood, 1958, pp. 206–210). First, he would adjust the maturity value of the debt downward for increases in the interest rate since issuance, a process which would have shaved $15 billion off the size of the debt in mid-1957. Next, he would capitalize the value of the stream of interest payments on the debt in accordance with the pure rate of yield on capital investment at the margin of use. This brings the sum of the debt down to $185 billion, a "pure" measure of the national debt in the sense that the net yield from $185 billion of earning assets in the private economy is obligated to the service of the national debt.

G. CONCLUSION

Trying to infuse into the debt ceiling as now stated any rationality as an indicator of debt burden probably goes far beyond its central purpose: to curb Federal spending. This paper has shown that it not only fails to accomplish this purpose, except in occasional episodes of arbitrary and capricious cutbacks, but that it involves heavy costs which are out of all proportion to any value it might have as a nostalgic symbol of passive and puerile government.

In the name of budgetary integrity, financial prudence, adequately financed national security, and aggressive policies to combat inflation and counterrecession—in other words, in the name of everything that is fiscally holy and wholesome—our anachronistic Federal debt limit should be abolished.

(The following was subsequently received for the record:)

COMMUNICATIONS WORKERS OF AMERICA,
*Washington, D.C., February 13, 1959.*

HON. PAUL DOUGLAS,
*Chairman, Joint Economic Committee of Congress,*
*U.S. Senate, Washington, D.C.*

MY DEAR SENATOR DOUGLAS: CWA wishes to add its voice to the many others pointing to the need for immediate action on this country's economic frontiers. We would like the attached statement filed with your committee and made part of its official record.

The only bright spot in the present dismal economic scene is the fact that a man of your capacity and devotion is chairman of the tremendously important Joint Economic Committee.

Sincerely yours,

J. A. BEIRNE, *President.*

STATEMENT ON BEHALF OF THE COMMUNICATIONS WORKERS OF AMERICA BY J. A. BEIRNE TO JOINT ECONOMIC COMMITTEE OF CONGRESS

On January 31, 1959, President Eisenhower appointed Vice President Richard M. Nixon chairman of a cabinet committee to explore and expose the problems of inflation. This committee's name is Cabinet Committee on Price Stability for Economic Growth. In addition to Vice President Nixon, Committee members are the Secretaries of the Treasury, Agriculture, Commerce, Labor and the Chairman of the President's Council of Economic Advisers.

It will be the Committee's duties to keep abreast of governmental and private activities affecting costs, prices and economic growth. In addition, it will initiate or have initiated by Government or private groups, studies of price stability in relation to economic growth and seek ways to increase American productivity and build a better public understanding of the need for price stability and how it can be achieved.

CWA regards establishment of this Committee by President Eisenhower as still another misguided substitute for action. It is our view that this is a Madison Avenue public relations response to this country's serious economic problems. There are already in existence many governmental and private research groups which have been studying these very same questions for many years. The U.S. Congress' Joint Committee on the Economic Report has been holding lengthy hearings on these same basic issues. In addition, the President's Council of Economic Advisers has been involved in the preparation and analysis of economic reports relating directly to these issues.

What is needed from the President is a statement of this Nation's economic goals and specific recommended actions to accomplish these goals. This is the primary responsibility of the President and his Cabinet.

The administration must restore full production and economic growth.

We must work out a list of national priorities in terms of our increasing responsibility in the world and our growing needs at home. This means putting first things first.

Many groups, including the AFL–CIO, have outlined in great detail before this Committee and others the need for immediate action in the field of national defense, higher consumer purchasing power and a reasonably stable price level, higher Federal minimum wage levels and extended coverage, better unemployment insurance, a more realistic Federal monetary policy, Government aid programs to depressed areas and other immediate and direct economic actions. Still another study group and White House slogans will not change the economic direction of this country.

The CWA views the President's Committee on Price Stability as a political ruse to give still another public platform to groups that will try to explain away unwarranted price increases and the continuing high levels of unemployment and economic stagnation.

We recommend to all organizations that this Committee is not an appropriate group with which to be working in our search for solutions to our economic problems.

(Whereupon, at 12:05 p.m., the committee recessed, to reconvene at 10 a.m., Monday, February 2, 1959.)

# JANUARY 1959 ECONOMIC REPORT OF THE PRESIDENT

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MONDAY, FEBRUARY 2, 1959

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met at 10 a.m., pursuant to recess, in room 457, Old Senate Office Building, Hon. Paul H. Douglas (chairman) presiding.

Present: Senator Douglas (presiding); Representatives Bolling, Reuss, Curtis, and Kilburn.

Also present: Roderick H. Riley, executive director; John W. Lehman, clerk.

The CHAIRMAN. Gentlemen, we appreciate your coming this morning. In a sense you talk not only to us but to each other and to the country. We do realize the inconvenience to which you have placed yourselves in preparing the papers and taking time out to come to advise us.

We are going to proceed in alphabetical order.

Mr. Barrett, we know that you have been ill and do not have a paper. We are therefore especially pleased that you should take the trouble to come, under such personal inconvenience, and if you would talk just informally on this matter we would appreciate it very much.

In the interest of time we are limiting ourselves to 7 minutes apiece. The acoustics here are rather poor. I am not certain that you even have any microphones. If you will try to speak in something more than a conversational tone, we will appreciate it. Thank you very much.

## STATEMENT OF HAROLD J. BARRETT, DEVELOPMENT DEPARTMENT, E. I. DU PONT DE NEMOURS & CO.

Mr. BARRETT. I would like to comment with respect to item 3 in the agenda, the importance of research and development as a factor affecting economic growth.

With respect to this item, I would like to cite a report entitled "Research, A National Resource."

The first part of this report submitted by the National Resources Planning Board in 1938 dealt with the relation of the Federal Government to research.

The second part submitted in April 1941 was entitled, "Industrial Research," 370 pages devoted to that subject.

A great deal has been written on this subject since 1941 but this report summarizes the importance of research to our national economy as well as any that has been written.

I would like to quote one paragraph from the section written by Dr. Stine on fundamental research. This paragraph is entitled "Fundamental Research and Foreign Affairs." It may seem strange to be quoting 1940 references in scientific affairs, but I think it is important because it shows the status at the beginning of the last World War as compared to the status at this time.

Dr. Stine writes this way:

In the light of world politics as this is written, the importance of maintaining and expanding research activities in America becomes particularly clear. Our ability as a Nation to hold and develop foreign trade and to provide adequate defenses will depend in no small degree upon our research activities, including those of the most fundamental character.

Twenty-five years ago Germany was supreme in dyes, pharmaceuticals, and nitrogen fixation, simply because they had built efficient industries upon a broad base of fundamental research that dated back 10, 15, and 25 years. No imagination is required to appreciate what this supremacy meant in her world commerce and her preparedness for war.

Fortunately, our woeful state of chemical insufficiency in 1914 is one lesson America took to heart. And, if we are to survive as a democracy in a world seething with predatory powers, then our defenses must be made secure, literally down to the last atom.

Whether or not we relish the idea, our leadership in science must not be relinquished if we are to be invincible in the arts of war as well as in the broad but none the less vital struggles of world commerce.

That is the end of the quotation.

I think that paragraph certainly applies today just as importantly as it did in 1940.

Another article I would like to cite is entitled "Scientific Research and the National Security," written by Dr. Alan T. Waterman, Director of the National Science Foundation, J. Carlton Ward, president of Vitro Corp., and Mervin J. Kelly, president of Bell Telephone Laboratories, one of the leading research organizations in fundamental chemistry.

This is written in three sections, one, "The Role of Government in Basic Research"; two, "Scientific Research and the National Economic Potential"; and three, "The Contribution of Industrial Research to National Security."

I do not know of an article that summarizes this subject better than this article, and I think copies should be distributed to the committee.

The CHAIRMAN. Will you have that done, Mr. Barrett?

Mr. BARRETT. Yes, I will have that done.

(The material referred to follows:)

[The Scientific Monthly, April 1954]

SCIENTIFIC RESEARCH AND NATIONAL SECURITY [1]

Alan T. Waterman, J. Carlton Ward, Jr., and Mervin J. Kelly [2]

I. THE ROLE OF GOVERNMENT IN BASIC RESEARCH

The National Science Foundation published, during the year 1953, a study of the distribution of funds for Federal support of research under the title "Federal Funds for Science." This study indicates that in 1953 an estimated $3.5 billion or more was spent in this country on scientific research and development. The Federal Government paid for a little over 60 percent, industry about 35 percent, and nonprofit institutions about 3 percent. Federal expenditures in

[1] Based on papers presented at the joint symposium of the National Academy of Economics and Political Science; Sections K and M, AAAS; and the National Social Science Honor Society, Pi Gamma Mu at the 120th annual meeting of the AAAS, Boston, Mass., Dec. 26–31, 1953.

[2] Alan T. Waterman served with the Office of Scientific Research and Development during

support of research and development for the fiscal year ending June 1953 totaled about $2.2 billion—an increase of $0.4 billion over the $1.8 billion expended in the fiscal year 1952. These estimates cover the costs of all research and development activities paid for by the Federal Government. They include not only work done by the Government but also work sponsored by it outside its own laboratories. It should not be concluded from these figures, however, that the Government program for research and development is increasing. As a matter of fact, the Federal budget for research and development is now decreasing, and the decrease will be reflected later in annual expenditures.

More than 20 Federal agencies, approximately half of the total number, administer programs in research and development. Seven agencies, however, administer 99 percent of the total funds. The Department of Defense, with about three-fourths of the total, administers the largest portion; followed by the Atomic Energy Commission; the National Advisory Committee for Aeronautics; the Department of Health, Education, and Welfare; the Department of Agriculture; the Department of the Interior; and the Department of Commerce. Approximately 94 cents of the Federal Government's research and development dollar goes for work of an applied research and development nature; the remaining 6 cents is for basic research.

How is basic research defined? To the academic mind, the expression presumably has a common meaning: typical academic research in the basic sciences. To representatives of industry and of government, however, the term "basic research" may have other connotations or shades of meaning. The explanation of basic research given by Dr. Bush in "Science the Endless Frontier" covers so many aspects of the entire question that it is useful to refer to it repeatedly:

"Basic research is performed without thought of practical ends. It results in general knowledge and understanding of nature and its laws. The general knowledge provides the means of answering a large number of important practical problems, though it may not give a complete specific answer to any one of them. The function of applied research is to provide such complete answers. The scientist doing basic research may not be at all interested in the practical applications of his work, yet the further progress of industrial development would eventually stagnate if basic research were long neglected.

"One of the peculiarities of basic science is the variety of paths which lead to productive advance. Many of the most important discoveries have come as a result of experiments undertaken with very different purposes in mind. Statistically it is certain that important and highly useful discoveries will result from some fraction of the undertakings in basic science; but the results of any one particular investigation cannot be predicted with accuracy."

Inherent in this definition are some of the reasons why Government is justified in the support of basic research, especially where it can be demonstrated that such research is not receiving adequate support from other sources. The technological progress that has occurred since World War II and the problems and progress that arise in medical science have demonstrated that a greater effort in basic research is needed in order to support the advances that are being made in applied and developmental fields. It must be borne in mind, also, that basic research is an important part of the training of research scientists and teachers of science, of which there are such critical shortages at the present time. As is known, these needs have developed during a period in which the facilities and resources of the universities have been taxed beyond their capacity. It seems appropriate, therefore, for the Government to insure a continuation of basic research by means of the grant-in-aid or contract, by fellowships, and by other types of support.

A Foundation study of Federal funds for scientific research and development at nonprofit institutions in the year 1951–52 disclosed that only about $1 of every $5 was for basic research. The other $4 went for applied research, development, and necessary additions to the research and development plants. The ratio of 4 to 1 between applied science and basic research seems to indicate

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World War II. After several years as Chief Scientist of the Office of Naval Research, Dr. Waterman became, in 1951, the first Director of the National Science Foundation. J. Carlton Ward, Jr., is an engineer and executive whose career has included intimate contact with many advanced scientific-industrial undertakings. Mr. Ward was formerly chairman of the board of the Fairchild Engine & Airplane Co. and is now president of the Vitro Corp. of America. Mervin J. Kelly is a research engineer and an experienced administrator of physical research. Dr. Kelly has served on several scientific committees of the Federal Government. He was formerly director of research and now is president of the Bell Telephone Laboratories.

a serious imbalance of effort and suggests the desirability of adjusting, to the extent possible, the disparity between the funds going for applied research and those available for basic research.

World War II produced great changes, both in the nature of the research being supported by the Government and also in the mechanisms by which it was supported. In the decade prior to World War II, the Federal Government was sponsoring research at educational institutions at the approximate rate of $6 million annually, most of which was for support in agriculture. The war shifted the emphasis to military research. A great innovation in the Federal support of research was the research and development contract between the Government and universities and other research institutions, introduced by the Office of Scientific Research and Development. The success of the contract system for the support of needed research and development established a pattern that was continued after the war and extended to include the research grant.

The Office of Naval Research and the National Institutes of Health were postwar pioneers in support by contract and grant, respectively, of research, both basic and applied. This support was largely by this project method, and they were later joined by the Atomic Energy Commission in its offsite program and by the other military departments. However, the greater part of such research was related fairly specifically to the mission of the agency. Except for the Office of Naval Research, which developed a broad program of extramural basic research, there was initially little support of research, except research more or less closely related to practical ends. The need for Federal support and encouragement of unrestricted reseach had been anticipated even befoe the war ended, and resulted in a 5-year effort on the part of scientists, legislators, and others, which was finally climaxed in the creation by Congress of the National Science Foundation. The Foundation was established, therefore, not to supersede or eliminate the research programs of existing agencies, but to provide a mechanism for the furtherance of education in science and the support of research on a very broad base. Another important function, in view of the growing magnitude of the Government's research programs, was to be the development of Government policy with respect to the promotion of basic research and education in the sciences.

In many ways, the interest of the Government in science can be compared with that of private industry, since the Government must take a practical view of spending public money. Its stockholders are the taxpayers, and what the Government does is accountable to them. The technical industries, faced with the necessity of their undertakings paying off, have realized their essential dependence upon basic research and are helping to support it in various ways. The Federal Government has realized, in principle at least, the necessity of supporting basic research for reasons similar to those of industry but broader and deeper, in that not only the economic welfare of the country but also the health of our people and the strength of our defenses are dependent upon a never-ending search for new knowledge. Traditionally, the general position of the Government has been to support the types of activity that are essential to the general welfare and that the States or private enterprise are not in a position to undertake. In other democracies, the list is longer than in this country, but in the United States the interest is in keeping it as short as possible. In recent years, however, the national welfare has come to depend, to such an increasing extent, on progress in science and technology that the support of research seems to be a proper function of Government for a number of reasons.

The first reason for support is the obvious one that the Government has need for research results and, therefore, must be able to call upon the most competent brains in the country, wherever these may be found. A second reason is that the interests of the Government may coincide with those of non-Government institutions. This might be true with respect to either basic or applied research, but more rarely in applied, insofar as universities are concerned (except in the fields of engineering, agriculture, and medicine). The mutual interest of the Government and the university opens upon the possibility of a cooperative venture with partial support from the Government. In such a situation, either the Government or the university might take the initiative in proposing the undertaking.

Another reason why the Government may properly support basic research arises out of a recognition by scientists that certain areas of research should, in the interest of the public welfare, be enlarged and supported to an extent beyond that which is possible with private resources. After World War II, for example, American physicists realized that the United States was lagging in the field of low-temperature physics, an area essential to the future of physics research in this country. Government assistance, initially by the Office of Naval Research and the Atomic Energy Commission was forthcoming, especially in provision of facilities which as helium liquefiers, and the research effort in the low-temperature field has been strengthened accordingly. In a similar manner, the Foundation has found that, in the opinion of biologists, systematic biology (taxonomy) was being neglected and that progress in biology was being retarded as a result. Foundation interest it the problem has resulted in the initiation of a broad program in this area.

The interest of the Federal Government in research is essentially a practical one. If basic research is the seeking for knowledge without regard to practical aims, why then should the Government support basic research? An individual investigator may be working on a project with no other motivation than the desire to satisfy his scientific curiosity or to add a bit of knowledge to a field in which he is interested. The Government, on the other hand, may be interested in his project to the extent of furnishing financial support because of the potential applicability of its findings to the solution of some larger problem. It is conceivable, also, that two Federal agencies might support the same project for entirely different reasons. The National Science Foundation, for example, might support a given project in metallurgy for no other reason than that it gave promise of advancing the frontiers of knowledge in that particular area. The Department of Defense or the National Advisory Committee for Aeronautics, on the other hand, might support the same project because of its possible application to jet engines.

A fourth reason why the Government should support research differs from the other three in that it pertains to other social needs. If, for example, the educational institutions of the United States should find themselves in financial difficulties that threatened to impair their ability to carry on their normal educational functions, then the national welfare might require some form of Government assistance. To the extent that universities find themselves in this kind of difficulty, it is appropriate to ask whether the Federal Government should relieve the situation by providing financial support.

In Europe, government assistance to universities in varying degrees is an accepted social pattern, but Americans look askance at direct Federal subsidy of their educational institutions. The tax-supported State universities and schools are regarded as a normal aspect of States rights, but Federal support is a different matter. It is not always generally appreciated, however, that tax exemption is a form of subsidy. Government support of research and development and Government scholarships and fellowships are other forms of subsidy that may help to relieve the pressure, and such measures appear to be generally more acceptable than direct subsidization.

It is now generally understood that the Government has a need for its own laboratories in areas where the work is not appropriate for industry or is not likely to be done under conditions that meet Government requirements. It is altogether proper, for example, that the Government should set and maintain standards of weights and measures and that there should be a national laboratory for this purpose—the National Bureau of Standards. Military research is the direct concern of the Government, and arsenals and gun factories are among the oldest Federal research establishments.

The most compelling reason for Government support of basic research, either in or outside its own laboratories, is to assure continuing progress of fundamental knowledge in science. In so doing, the Government will not only serve its immediate foreseeable developmental needs but will also utilize science to the fullest extent as a national resource. An agency should, therefore, be free to establish and maintain such research under whatever conditions are most favorable to the satisfaction of its particular requirements. For this reason, it is neither feasible nor desirable for a single agency of the Federal Government to support all the basic research in which the Government is interested.

Government support of research, like other large-scale efforts, is not without problems. Educators and administrators, for example, are increasingly concerned with the effects of Government research work upon the normal teaching and research functions of our colleges and universities. The National Science Foundation is aware of some of these problems and feels that the impact of Federal research upon our colleges and universities is a national problem that should be closely examined. The National Science Board has recently authorized the appointment of a committee, under the chairmanship of Mr. Chester I. Barnard, to consider the entire question. In addition to considering the effects of Government funds upon the customary teaching and research activities of colleges and universities, the committee will also consider the question of how the Federal Government, in cooperation with the colleges and universities, may best develop and encourage research and education in the sciences.

Those who are close to matters of research realize that the role of Government in basic research is a proper one and one that is likely to grow rather than to diminish in the coming years. It would be well if the public also understood and appreciated the significance of research in our national life, especially since, as has already been seen, science will continue to raise questions with which society as a whole must deal. In the entire question of the participation of the Federal Government in support of science, the concern should be to insure that the Government's role is carried out in such a manner as to make possible the maximum benefits to be realized from wise policy and administration, and that any detrimental effects are understood and held to the minimum.

### II. SCIENTIFIC RESEARCH AND THE NATIONAL ECONOMIC POTENTIAL

Anyone working in the field of research immediately recognizes that the terms "basic" and "applied research" define areas that in concept may differ but in practice shade one into the other. Research also is often confused with the engineering phase of development. It is obvious that research does not apply merely to the so-called sciences but applies equally well to unscientific, or perhaps more accurately, incommensurable material, as dealt with in the social sciences or the humanities.

It would be difficult indeed, if not impossible, to find any area of either thought or action that has not been affected and shaped by the results of research. Research, thus, is seen as a fundamental process by which the life of mankind, man's relationship to man, and man's relationship to nature evolves through time. Early work in arithmetic and geometry made possible the great structures of the ancients, which played such a vital part in their social and spiritual life. In more modern times, the work of Newton presaged the mechanical civilization which was shortly to follow, and now in current time is seen the work of such men as Hertz, Becquerel, Planck, and Einstein to bring forth a new civilization that is entering into what is popularly called the atomic age.

How do the discoveries of such great theoretical research workers affect the economic potential? Obviously, there are many links in this chain. Following the results from theoretical research efforts, there must naturally follow experimental verification. At this point new knowledge has become available, but it is still sterile insofar as the economic implication is concerned. Applied research next is effected and proves that such new knowledge will and can accomplish a useful purpose. This stage in turn is rapidly followed by the engineering application, which is called development. This step finally reduces the original knowledge to a useful economic factor, such as a new machine, a new material, a new process, a new product, or a new form of service. Out of such elements, the national economic potential is created.

The national economic potential can be interpreted as a nation's total capability. It includes capability to progress in a material sense, capability to progress in a moral and intellectual sense, and capability in a world of complex forces and pressures to maintain its own freedom, its own philosophy, and its own integrity. The standard of living is often considered to be the index of the national economic potential for any given nation. The term capability, as used here, is intended to have a broader meaning—that is, competence in all national aspects and relationships and not merely in material matters affecting the standard of living. The key role, and the predominant role, that scientific research plays in developing the national economic potential, therefore, becomes obvious.

Germany emerged during the period prior to World War I as a great industrial nation founded upon advanced technology. Germany, at that time, had insufficient agricultural resources and a lack of suitable minerals and other raw materials and was deficient in natural power resources. Yet with a population not much larger than its principal neighbors, and much smaller than its largest neighbor, it emerged as a leader in world trade. It had a constantly expanding standard of living, accompanied by many advanced forms of social progress. Its great chemical industry was a marvel of the world and had by research produced new drugs, new dyes, and many new materials and processes. Other technological industries were introducing new machinery and new processes that were the envy of the rest of the world.

How could a nation deficient in natural resources and limited in geography become such a dominant power in competition with other advanced nations? No simple answer serves the purpose, but an example will prove interesting. Although British and French chemists had formed the groundwork for the new synthetic chemical industry, the German nation was the first to exploit it. Its chemical industry employed the most enlightened methods of research in organized laboratories of greater size than could be found elsewhere at the time. German universities attracted leading scholars in the sciences from the entire civilized world. Theoretical and applied science, basic and applied research, and technical development all teamed together to overcome the economic disadvantages of a nation poor in natural resources. Germany, thus, provides an excellent example of the close relationship between scientific research and the national economic potential.

It was early in the 1800's that the United States gave to the world the concept of mass production. This followed naturally from a civilization that was built upon a generous inheritance of natural resources and suitable industrial manpower, the latter of which continued to flow in largely from the older countries of Europe. The adoption of mass production was destined to play a major role in the national economy and was undoubtedly one of the greatest of all technological developments. This technique, however, may be described more accurately as an engineering development than as one stemming from the process of scientific research. In 1902, the first research laboratory appeared on the American industrial scene. This was the General Electric Laboratory at Schenectady. America, however, continued to be the importer of foreign scientific ideas and technology. But it is generally conceded that the United States today continues to lead in the application of mass production techniques and that such methods are making a major contribution to the economic potential of the country.

Just prior to World War I, American inferiority with respect to the field of scientific research came clearly into focus. America had relied to a large extent upon the products of the great German technical industries for scientific instruments, precision optical systems, synthetic chemicals, and dyestuffs; and the deficiencies in the war effort proved that the economic potential was limited and lacking in a diversity of scientific resources. It has been stated that there were less than 10,000 physicists in the United States at that time. Various Government bodies were created to survey the situation and organize the scientific talents of the country toward the common defense. For the first time, large industrial corporations became aware of the fact that, wittingly or unwittingly, they had depended upon the fruits of foreign research. Then followed the great expansion of research laboratories and the acceptance of the concept of scientific research. The literature of the period indicates that the word "research" took on some mystical significance and became a slogan for many things remote from the current concept of scientific research.

In the field of the national defense of the United States, the Industrial College of the Armed Forces in Washington, D.C., with the National War College and with the Joint Staff College at Norfolk, Va., constitute the highest educational facilities within the Department of Defense. All three organizations come directly under the cognizance of the Joint Chiefs of Staff and, therefore, embrace all the armed services. The very fact that the Industrial College was established on this high level of the military educational system is an indication of the importance that economics now plays in planning for the defense of the country. The Industrial College assigns a major group of its faculty and a portion of its curriculum to the role of technology. In this area of its studies, the concept of scientific research plays a key part.

It has been forced home on the leaders of the armed services that wars are won or lost on the basis of the national economic potential rather than on the current strength of the Armed Forces. The upper limit of effective mobilization, military strategy itself, and the allowable specific combat effort for any given operational area are directly derived from the economic potential of the country. It has, therefore, become of vital importance to the preservation of the Nation that its military leaders be taught to understand the function of technology and the basic role of scientific research in forming the economic power from which the logistic support of all combat operations is derived.

Referring to the growth of research in the United States, figure 1 illustrates the startling recognition of the function of research and its acceptance by Government and by business in the last 20 years. This chart shows the extraordinary acceleration of research under the impetus of World War II, followed by the recognition of the importance of research in the period of the "cold war." The professional term "military posture," as used today in diplomatic circles, reflects the contribution that scientific research has made.

The recent volume of David E. Lilienthal, "Big Business: A New Era," states that the diesel engine was 30 years under research and development before coming into general use, and likewise, that Du Pont's nylon was the product of 13 years of effort and an expenditure of more than $20 million before the first bolt of material was marketed. It has been stated also that Monsanto's Krilium is the product of 11 years of research; and the modern gas turbine, well known in theory before World War I, became a factor for the first time in World War II, more than 30 years later. These examples are illustrative of applied research and development and are instances of specific applications, but the fundamental scientific developments from which they were derived long preceded them.

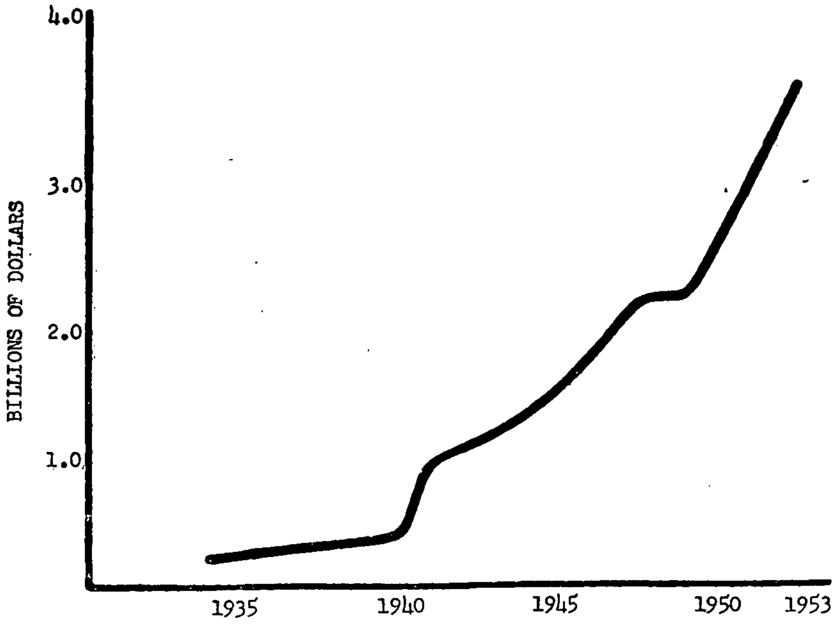


FIGURE 1.—Growth of research in the United States, based on estimates from the Research and Development Board and Steelman report. (From a lecture by Clyde Williams, of the Battelle Memorial Institute, before the Industrial College of the Armed Forces.)

The sources and distribution of expenditures for research and development in the United States today, by agencies, are indicated in figure 2. One of the most important and significant developments in this field is the work that is done in

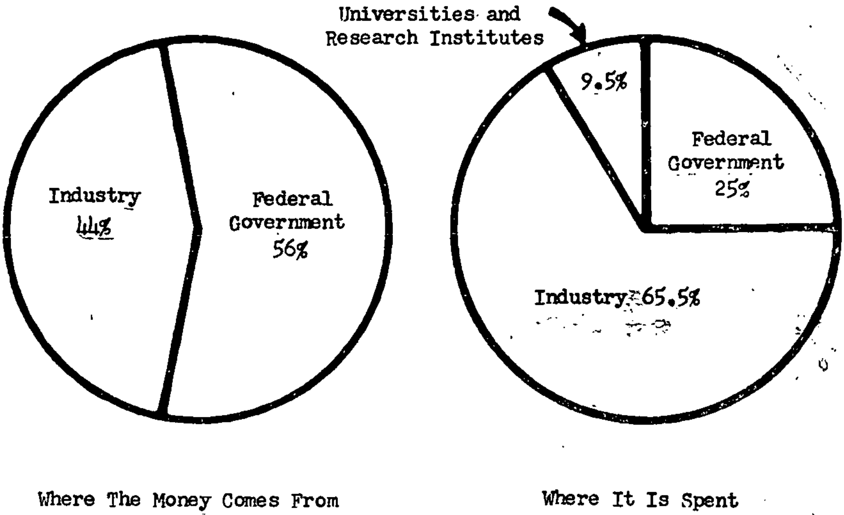


FIGURE 2.—Spending for research and development for the year 1952 (National Industrial Conference Board)

universities and nonprofit research institutions. This effort, in 1952, amounted to 9.5 percent of the total; today this percentage is considerably larger. The role of this group is relatively new and would hardly be apparent on any normal chart reflecting the total research done prior to the late 1930's.

A large American industrial unit in 1952 installed three vital new processing techniques, with all their equipment. One originated in Poland, one in Sweden, and one in Italy; these were the three most important new processing developments for the period in question.. This adaptation is an example of American alertness to foreign research and technical development, the fruits of which, in nearly every instance, have subsequently been improved. The contribution to our own economy from such sources is often not adequately recognized.

Until very recently, only in the older civilizations was there to be found a natural encouragement for men of exceptional scholastic ability to pursue their theoretical studies in the cloistered atmosphere of universities. If the great fundamental scientific developments leading to the new atomic age are studied, it will be found that it was France, England, Poland, Germany, Switzerland, Australia, Denmark, and Italy which contributed the majority of the great theoretical ideas. This occurrence was in spite of the fact that the experimental effort and the final development of the end products of all this research were first manifest in the United States. It should be added that, in general, big business is yet unaware of the key role that universities must play in generating

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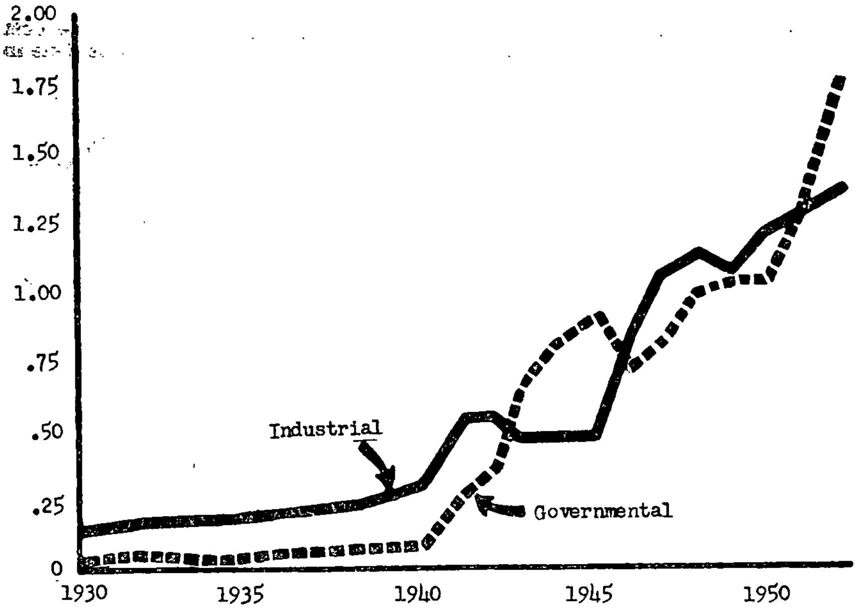



FIGURE 3.—Growth of research in the United States in billions of dollars (Industrial College of the Armed Forces).

a favorable atmosphere in which exceptional scholars will work. These scholars are the men from whom will come the new scientific and philosophic concepts that will expand outward the boundaries of knowledge from which technological progress emerges.

Figure 3 indicates the extraordinary relationship between the growth of research in Government relative to its growth in industry. "Research" is used in this chart comprehensively to include the social sciences, the life sciences, physics, chemistry, mathematics, and associated fields. In monetary terms, this illustration can be misleading, since the least expensive research is that which is solely in the realm of ideas, statistics, and philosophic concepts.

Figure 4 shows the gross national product of the United States in billions of dollars and the population growth of the country. It is not certain that a precise correlation can be made between such a curve and that of the growth of research as reflected in figure 1, since the relating factors are not simple and direct. It can be fairly stated, however, that the gross national product could not reflect the enormous growth represented in figure 4 without a corresponding effort in the field of research and development as indicated in figure 1.

Figure 5 illustrates graphically the quantitative comparison of the standard of living in a number of principal countries. A measure of the national economic potential of any country is based upon the total power available. Thus, the standard of living in any country can be shown to be coincident with the power available per unit population per year. The U.S.S.R. ranks below the middle of the list but is making rapid strides forward from year to year. The statistics on trained scholars, engineers, and technologists in Russia today, as compared with the United States, and the emphasis placed by the Soviet Government on industrial and scientific research readily indicate the relatively rapid progress in this field in the Soviet Union.

Figure 6 shows the remarkable correlation between the power output per unit population in the United States beginning in 1902 and that of the standard of living expressed in standard dollars for the same period. It is interesting to note the effect on the standard-of-living curve of the depression of the 1930's and the boom period of World War II in the 1940's. Except for these two major effects, the curves of the graphs are parallel throughout, and the conclusion might be made that the national economic potential, as well as the national standard of living, are each reflected in the power available per unit population per year. It should be evident that production results from available power and that new products result from research and development as well as do the methods and processes for their production.

The Du Pont Co. has developed a chart, reflected in figure 7, that indicates the enormous contribution made by machine labor to the standard of living, the national product, and, hence, to the national economic potential. A century ago the national economy reflected almost entirely the physical work of men and animals. Today, it is approaching the forecast ideal of the year 2003, when it will be based almost wholly on the machine.

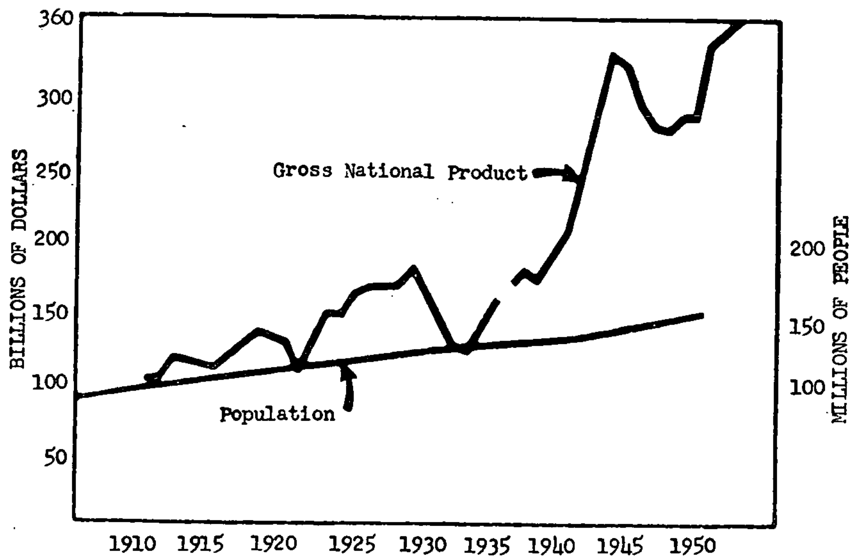



FIGURE 4.—Gross national product of the United States in billions of dollars and the population growth of the country (Industrial College of the Armed Forces)

The contribution to the economy of the Nation by the technological development of materials has been important in the recent past and will continue to be so in the future. Many new organic products are now available to industry. The new technology of chemurgy, for example, may prove to be the answer to many of the problems raised by the Paley Report of the President's Materials Policy Commission in its study of the resources for the future. Other examples of new fields of technological development with tremendous implications for the future are atomic power, coal hydrogenation, oil-shale extraction, radiation synthesis, and ultrasonics. All these fields will depend upon research and development for their realization.

It would be impossible to overemphasize the importance to man of the atomic age. Dr. Farrington Daniels, of the University of Wisconsin, has pointed out the limited natural resources of the world and their degree of exhaustion as civilization builds ever higher levels of living. It is stated that there is estimated to be 23 times as much atomic fuel suitable for energy available in the earth as there is the sum total of all the fossil fuels of oil, gas, and coal. The Paley report forecasts in a dramatic manner that by the year 2023 mankind will have insufficent sources of fossil fuels to maintain civilization in the standard of that time. How better can the role of research and development be portrayed than to show that it alone can resolve this dilemma?

Modern cosmologists point out that the earth is roughly 2½ billion years old. The earliest remains of man are indicated to have been discovered a little over 15 years ago and to be approximately 1 million years old. Civilization is recorded only for the last 6,000 years. Yet the cosmologists relate that the atomic cycle of the sun forecasts 6 billion more years of suitable climate on the earth in which mankind can carry forward his evolution and his existence. How could even a minute portion of this God-given future be utilized for the betterment of man without an accelerated and continuing emphasis on the role of research and development?

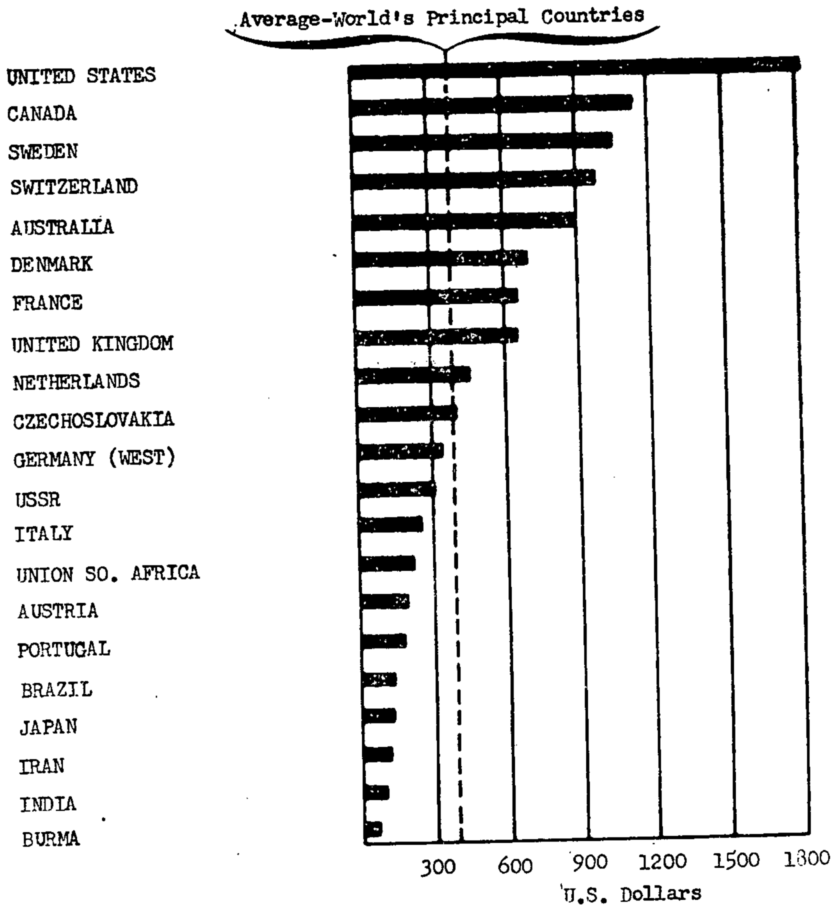



Figure 5.—Per capita income in various countries for 1951, in equivalent U.S. dollars (Industrial College of the Armed Forces).

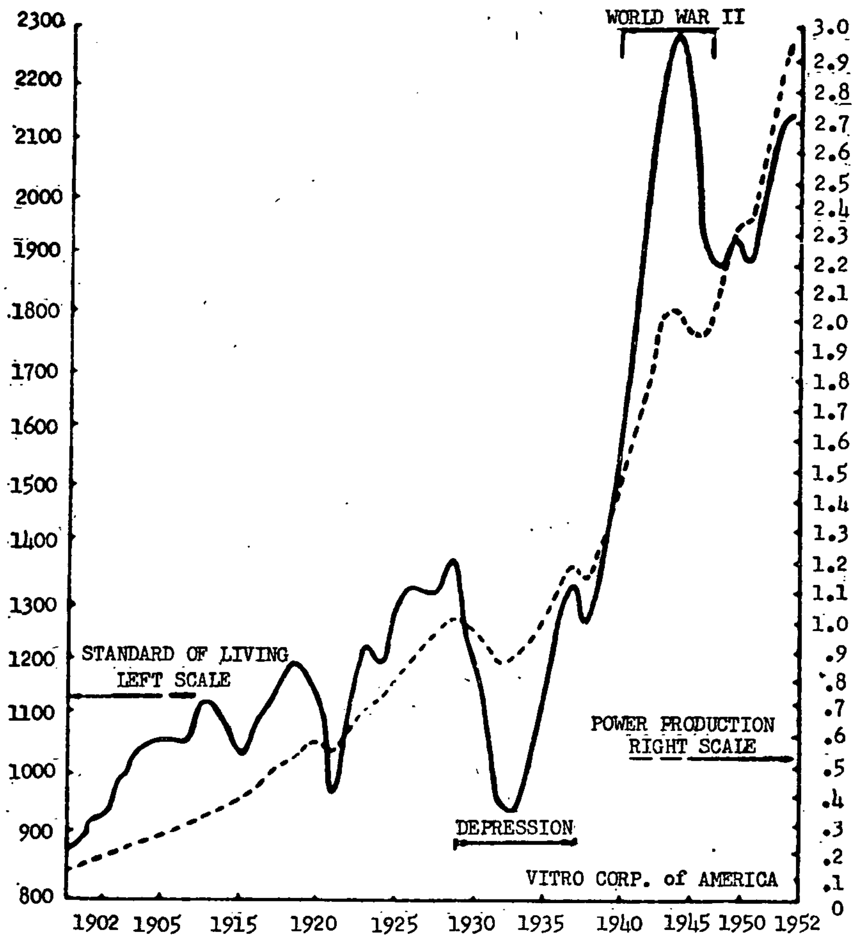



Figure 6.—Standard of living compared with available energy per unit population. The left-hand scale represents constant dollars of gross national product per capita. The right-hand scale represents kilowatt-hours per capita.

III. THE CONTRIBUTION OF INDUSTRIAL RESEARCH TO NATIONAL SECURITY

It is the tragedy of the time that our Nation's primary concern is with its security. The Communists, dominated by the Kremlin of Moscow, are attempting to destroy the governments and social structures of the free world through threat of an all-out war, while at the same time attempting to attain their goal through so-called cold war techniques of their creation.

America can remain free and be secure only if it protects itself from both of these techniques aimed at its destruction. The Nation's program for its protection is the building of a military potential of great strength while maintaining a healthy and expanding economy. A military strength of such obvious effectiveness is being created that it should deter the Kremlin from seeking to attain its goal by the military route; however, should the Kremlin, through plan or accident, precipitate a war, the free world should be the victor. While building this strength, America is maintaining a healthy and expanding economy in which all citizens share its social and economic benefits. This structure offers protection from the cold war tactic in which the Kremlin hopes to "bore from within" by building internal Communist revolutionary strength in an atmosphere of economic chaos where a significant number of the citizens are in the mood for a radical change in the pattern of society.

Industrial research contributes to national security through its application of scientific knowledge in the military area to the creation of new weaponry and in the civilian area to the creation of new facilities of benefit to the economy and to the enrichment of life. Other research laboratories of the Nation join with those of industry in this contribution. The laboratories of Government, of academic institutions, of foundations, and of industry are increasingly joined in unified research programs. Their contributions to the military have made our Nation the arsenal of the free world and the leader in the struggle to maintain its security. At the same time, their output for the civilian area is basic to an abundant and expanding economy.

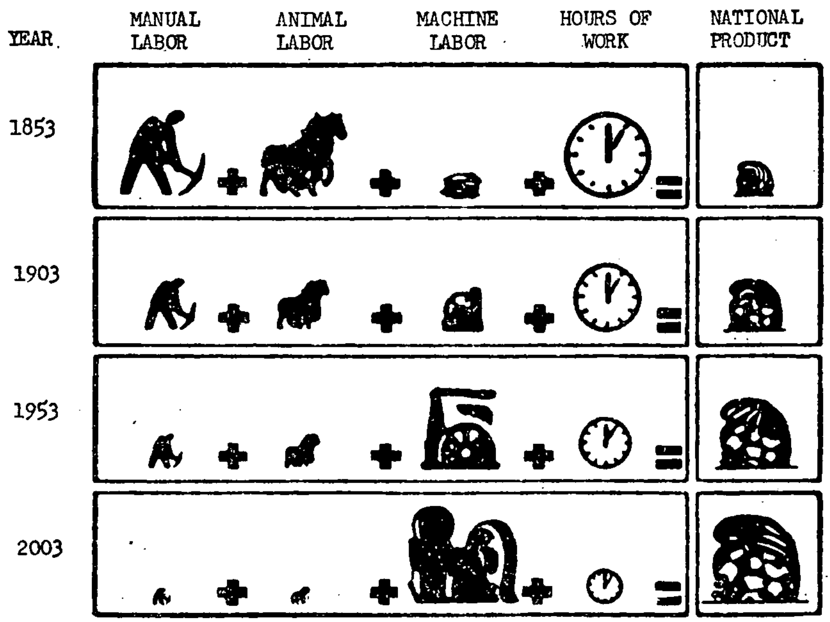



FIGURE 7.—Increasing contributions of the machine to the national product. (E. I. du Pont de Nemours & Co.)

The statistics of the current dollar volume of the Nation's basic and applied research effort are most impressive; in fact, their magnitude is astronomical. The contributions to military strength and to the civilian economy that this level of expenditure produces are even more impressive. The Nation applied only a negligible fraction of its basic and applied research strength to new weaponry before 1940. During the period 1940–45, research laboratories made revolutionary changes in the character of warfare. "Radar," "sonar," "proximity fuse," acoustically homing torpedo," and "atomic weapon" are terms that were completely unfamiliar in the 1930's. These terms, along with many others, are descriptive of the new weaponry that was created by research talent and were produced by industry in World War II. Without question, their application to warfare hastened victory with a saving of American lives.

Since the close of the war, the Nation's laboratories have continued their application of scientific knowledge to improved weaponry. The weapons of World War II were still in their pioneering stage at the close of the war; they have been greatly improved and new weapons are constantly added to our arsenal. The advances have been most significant in atomic weaponry and the mechanisms and methods of their delivery. Their combined effectiveness is appalling. A variety of atomic-weapon types ranging in destructive power from the tens to the hundreds of kilotons of TNT equivalence are now available. Methods of delivery ranging from supersonic piloted bombers through electronically guided missiles to rockets and cannon are either in being or near at hand. The military effectiveness of the atomic warfare that these new weapons and their methods of delivery have generated is given such a high effectiveness rating that, in the current planning for defense in the years immediately ahead, significant reduction in manpower is contemplated with no sacrifice in military strength.

The contributions of basic and applied research to the civilian economy are important in the maintenance and preservation of the free society that has evolved under our capitalistic system of democracy. If the social and economic structure of a society provides its people with a good life, with not too great variation in its quality from the bottom to the top of its structure, and accompanies this with a reasonable amount of leisure for all, the overwhelming majority of the members of that society are then content with it as a framework within which to live. Conversely, if the economic and social structure of a society fails in providing this environment, then a significant number of its members are discontented and ready to turn to another structure of society that gives promise for such an environment. In countries where the latter condition prevails, the Communists have been, to varying degrees, successful in promoting their philosophy and creating a desire for revolution.

The quality of living of the people of America is at the highest level in the world. This condition has been attained while the hours of work to provide it have steadily decreased. Increasingly with time, its richness has been extended to all members of society. Differences in quality of living from the so-called top to the bottom have been steadily narrowed, while the level of all has been raised. There is, thus, an environment that is unfavorable to the Communist, and he has had in fact little success in having his revolutionary philosophy accepted. These qualities of society are of great importance to national security. A military potential of maximum strength will not suffice for the preservation of free and democratic society unless it maintains and gradually enhances the qualities of living of all its people. The Nation's basic and applied research is, perhaps, the most essential of all the elements that contribute to these qualities of American life.

Two examples will illustrate the operation of applied science and technology in the rise of the standard of living. Agriculture is chosen as the first, since it is basic to existence. In the past 30 years, the food production of the world has increased by less than 10 percent, while the population has expanded about 30 percent. In the United States, while the population has increased about the same amount, food production has expanded more than 50 percent. This rise has been accomplished with substantially no increase in farm acreage but with a significant decrease in farm population. Thirty years ago the farm population was some 30 million. By 1950 it had decreased to some 24 million, and the farmer's hours of labor have significantly decreased.

The increase in food production with a decrease in man-hours required and with the utilization of substantially the same farm acreage has been made possible by the application of scientific knowledge to the food-production problem through applied research and technology. Mechanizaiton of the operations of farming played an important role. With the increasing effectiveness of cultivating machinery, the tractor and its driver can cultivate, and more effectively, in excess of double the acreage formerly done by two horses and a man. The energy for driving the tractor is oil, a mineral product, while the energy for sustenance of the horse had to be obtained from the acreage it cultivated. In 1952 farmers purchased about 100,000 power machines as aids in their ever more efficient food production.

The applications of chemical knowledge have been at least as effective in increasing the efficiency of food production as has mechanization. Fertilization of the soil by a variety of relatively low-cost chemicals increases the productivity of the soil. A great variety of organic chemicals are also used, such as herbicides, soil conditioners, fungacides, defoliants, growth regulators, and insecticides. The names of these chemicals are adequately descriptive of their use. Thirty years ago most of them did not exist. Farmers purchased some $400 million worth of these chemical products in 1952.

The chemical industry is the source of the fertilizers and the organic chemicals for a variety of agricultural applications. It is one of the younger industries and is, perhaps, the fastest growing. Its contribution to national strength through aids to civilian economy and to the military are of growing importance, for, as the natural products of the inorganic world become depleted, it is to organic chemistry that we must turn for the essential materials of industrial society. Research and development are the cornerstone of this vital industry; scarcely a year passes when each of the dozen or so larger chemical companies, through their research and development programs, do not add from 10 to 15 new products for the industrial or consumers' market. Forty percent of chemical sales is accounted for by products that did not exist 15 years ago. In 1937 the sales volume of the products of the chemical industries was about $700 million, while today it is in excess of $4 billion.

The chemical industry, among its many contributions to military strength, has given distinguished service to the Government in using its management, research, and engineering strength in the development of plants and their technical processes, and then in operating the plants for production of products essential to military needs. Synthetic rubber, fixed nitrogen, and processing of uranium ores are typical of the specialized Government-owned plants to which the chemical industry has contributed so much of management, research, and engineering talents. Chemical research, in which that of industry is the largest element, is vital to national security in the military and civilian areas.

The second example of applied science and technology is taken from the service industries. Communication is becoming increasingly important in the Nation's economic and social life. Thirty years ago the Bell System, which supplies a little more than 80 percent of the Nation's telephone service, served some 8 million telephone subscribers. Today, its service is used by about 41 million subscribers. While the number of stations has increased fivefold, this fact is an inadequate measure of the increase in service that the system provides. Thirty years ago, because of limitations imposed by technology, the distance of telephone communication was severely limited in comparison with today. The conversation of most subscribers was restricted to an area perhaps not more than 50 miles in radius, although a limited number were beginning to talk across the continent. Today, through telephony, the entire Nation has become a neighborhood. The extended area of use of telephone service has grown to such proportions that the development of nationwide subscriber dialing to provide more rapid and more economic service is well advanced. When these facilities are nationally installed, any subscriber in the Nation will be able, through dialing, to interconnect with any other subscriber in the Nation. The range of telephony is not restricted by national borders. With the aid of Bell System transoceanic radio telephone circuits, any subscriber may be connected with most of the 33 million subscribers beyond our borders. Bell System service has also been extended to record communication where a teletypewriter can "talk" to any other teletypewriter anywhere in the country. National radio and television program circuits distribute programs to the hundreds of radio and television broadcast stations throughout the land.

This fivefold increase in telephone stations, enhanced long-distance service, and new record and broadcast service are all supplied with only a threefold increase in number of employees in the operating companies of the Bell System. Some 30 years ago, there were 225,000 such employees, while today the number is approximately 600,000. The fivefold increase in number of people served, the improvement in quality and the extension of service, and the new services have been realized with only a threefold increase in operating personnel through the application of new scientific knowledge by industrial research and technology.

The Bell System at its Bell Telephone Laboratories maintains a large research and development organization for converting new scientific knowledge into new telephone technology to make possible more economic, improved, and extended telephone service. The growth and increased scope of telephone service that has been described has been possible only through this conversion of scientific knowledge into technology.

Telephone technology has much in common with that of new weapons systems, particularly in their automatic guidance and direction. Bell Laboratories, along with the other communications and electronic laboratories of the Nation, have made large contributions to the development of weapons systems. In the period since 1940, for example, almost one-half of Bell Laboratories expenditures has been for research and development for the military. Weapons systems of great variety have resulted from this work and have been produced for the military in dollar volume well in excess of 4 billion.

The basic freedoms and the cultural values that the individual of the Western World enjoys are now threatened by the dynamics of communism to a greater extent than at any time in the history of western civilization. Our Nation, with its great strength and dedication to freedom, must lead and make the largest contribution in the preservation of these values inherent in western society. The continued security of America is vital to this leadership and contribution. The research of the Nation is essential to the maintenance of this security. Industrial research is carrying out some two-thirds of the research program. Looking to the future, its responsibilities are increasingly great. The Nation's industrial research is strong and is virile; it may be assumed that it will continue to measure up to its responsibilities.

Mr. BARRETT. The discovery and development of new scientific principles has had tremendous economic effects in our civilization. However, Americans have been better at developing than they have been at discovering scientific principles. Many of the primary concepts we have developed into useful products have come from Europe. In general, Europeans have been more painstaking fundamental or basic researchers, discoverers as stated in the President's report "of new avenues of fundamental advance," which I would say is a good definition of basic research.

Americans, with their excellent engineering ability, their raw material advantages, and their larger unimpeded market for new and improved products, have shown superiority in applied research and development. With the organization of European common markets and free trade areas the marketing and production advantages we have enjoyed may be diminished and Europeans will be more prone to develop their own basic scientific discoveries. Therefore, it is important for Americans to give increased attention to the discovery of fundamental concepts; that is to say, to concentrate on basic research.

The steps that have been taken by the National Science Foundation and other Government agencies by scientific societies such as the American Chemical Society and trade associations and by industrial firms for the encouragement of basic research in colleges and universities should be supported.

In addition to the discovery of new principles, new avenues of fundamental advance, this will assure us of a supply of well-trained researchers, the scientific brainpower factor that is so important to our economic growth.

The CHAIRMAN. Mr. Barrett, I am going to take the liberty of slightly altering our usual procedure. We normally have the members of the committee refrain from asking questions until all the members of the panel have expressed themselves, but I may have to leave to "mark up" a housing bill, so that, if you will permit me just a few questions, we will then go on.

An eminent industrialist, who later became a leading public servant, once defined basic research as "not knowing what you want to do."

Later he said, as an illustration of basic research, "The question was, What makes the grass grow green?"

Now, what would you say about these definitions of basic research?

Mr. BARRETT. I think they are a little broad. The broader you make the definition of basic research in any survey to see how much basic research is going on the less dependable facts you get. You have to narrow it down.

Dr. Stine defines it in the first of his article in this way: He calls it fundamental research but there is no difference, as I see it, between fundamental and basic.

The CHAIRMAN. Do you think those were very helpful definitions, Mr. Barrett?

Mr. BARRETT. This definition, I think is.

The CHAIRMAN. I mean the definition of the eminent industrialist who later became a leading public official. Do you think those were helpful definitions?

Mr. BARRETT. No. I say this is the definition we stick to pretty much: Fundamental research is a quest for facts about properties and behavior of matter without regard to a specific application of the facts discovered.

The CHAIRMAN. Do you regard the promotion of basic research as a proper subject for the Federal Government to spend money on?

Mr. BARRETT. I think in certain lines they should, because industrial research organizations are bound to point toward their economic ends. We have devoted quite a bit of time to basic research but it is a tough job to stay on basic research and not get it into films, fibers, finishes, or what not; however, out of our basic research came some of our best results in those fields.

The CHAIRMAN. If it is a function of the Federal Government to spend money for the promotion of basic research, should these funds be administered by the Department of Defense or by the National Science Foundation?

Mr. BARRETT. Some central organization should catalog all research that is done by the Government. I think the cataloging of that research is important.

The CHAIRMAN. Do you think it should be done by the Department of Defense as a central organization?

Mr. BARRETT. Just that which applies to defense. There is a large amount of research that applies to health and welfare and there may be others.

The CHAIRMAN. If it applies to defense, that is applied research, is it not?

Mr. BARRETT. It could be very broad fundamental aspects of ballistics, fundamental aspects of metals that are too broad to have any direct application.

The CHAIRMAN. Do you think in those cases the funds should be administered by the Department of Defense or by the National Science Foundation?

Mr. BARRETT. They probably should be administered by the Department of Defense but certainly there should be some overall catalog and recommendations regarding avenues in which we are not doing fundamental research. Sometimes that is your most costly research, the research you are not doing, and to find the blank spots is, I think, one of the most important parts of any research organization. Maybe the Department of Defense would not find those, so there ought to be some overall cataloging of fundamental research supported by the Government.

The CHAIRMAN. Suppose the Department of Defense decided that this was a useless enterprise, not knowing what you want to do, but the National Science Foundation felt that it was a fruitful line of investigation; should the National Science Foundation have the authority of the funds to promote this research?

Mr. BARRETT. That is a very good question.

The CHAIRMAN. We want advice, you know.

Mr. BARRETT. I can imagine a case like that coming up in which the problem was too broad and fundamental for the Defense Department to see the particular immediate application for the research.

After all, they have just a certain amount of money to spend, but the problem should be attacked from a long-distance fundamental point of view. Basic research is not research for next year or the year after next.

The CHAIRMAN. I understand.

Mr. BARRETT. It is research for 10 years from now.

The CHAIRMAN. That is correct.

Mr. BARRETT. Therefore, there might be a seeming contradiction of opinions like the one proposed.

The CHAIRMAN. Then what you seem to be saying is that the National Science Foundation should be given more funds and that possibly the Defense Department should not have the power of veto over all basic research projects.

Mr. BARRETT. They should have very strong recommending powers at least.

The CHAIRMAN. Thank you very much.

The discussion will be continued by a distinguished citizen of Illinois, Robert Eisner, professor of economics, at Northwestern University.

## STATEMENT OF ROBERT EISNER, ASSOCIATE PROFESSOR OF ECONOMICS, NORTHWESTERN UNIVERSITY

Mr. EISNER. Economic growth depends upon prosperity. Prosperity depends upon economic growth. To stay at any high level of economic activity we must have that level of activity ever rising. This is the central paradox—and challenge—of our economy.

Each time that we allow any substantial amount of unemployment, such as the more than 4 million totally unemployed according to figures for December 1958, we sacrifice major opportunities for growth. And each time our rate of growth slows, we face the imminent danger of a recession, with its consequent unemployment and hardship.

Many of us have tried to explain this in careful scientific terms in our professional economic journals. But the essential relationship should be easy to see. When we have rapid economic growth we are rapidly acquiring new plant and equipment and thus utilizing the vast savings which a prosperous Nation makes available. But if our growth is slow there is insufficient demand for all of the saving that a prosperous people offer. This in turn results in conversion of a slow rate of growth into an actual decline, as the people who would be employed in building new plant and equipment and in otherwise expanding the economy lose their jobs.

Put another way, saving contributes to growth. But unemployed workers and businesses losing money dissave; they use up past savings. Each million idle workers and the corresponding idle resources cost us perhaps 1 percent in our rate of growth. Thus, by way of illustration, if with 4 million unemployed we can grow at 3 percent per year, then with 2 million unemployed we can grow at 5 percent per year. The decision to accept unemployment, whether in the view that it is necessary to prevent prices from rising or for any other reason, is a decision to accept a lower rate of growth.

While I have stressed the role of capital expenditures—the building of new plant and equipment—in economic growth, capital is only one of the factors in output. We can grow by putting more capital to work. We can also grow—and this is very important—by putting more hands and brains to work. As to the latter, brains must be trained. An essential part of continuing growth must be superior education and the advances in skill and progress which are its byproducts.

Given general prosperity, individual companies can probably be counted upon to invest in the research and development of immediate application which will increase their profits. What may be neglected, and I believe is neglected, is the investment in basic science, and social science, of the kind that is done by universities, nonprofit research organizations, and Government. We face a serious danger that private companies in their understandable interest in research and development will make even more scarce the resources available for the fundamental advances on which growth must largely rest.

Hence the role I view for Government is largely twofold.

First, it must take necessary measures to see to it that we maintain full—and more than "full"—employment.

Second, it must make certain that there is adequate investment in human beings, in education, in training the minds that will make the breakthroughs of the coming years. In my judgment we have been grossly deficient in both of these tasks.

Thus we can have a faster rate of growth without necessarily devoting a larger proportion of our resources to capital formation. First we can, by maintaining a higher level of employment, have more resources for capital formation by taking the same proportion of a larger total.

Second, we can have a faster rate of growth by devoting more resources not only to capital formation but to brain formation, by spending more on education. Investment in education, it may be added, may help meet problems of income distribution which may be associated with rapid capital accumulation. For capital assets tend to be relatively concentrated in ownership. With better education all will gain, and high incomes and wealth may be found more widely among the owners of talent, as well as the owners of stock.

However, to the extent we wish to add to investment in both physical and human capital more than what can be produced with resources now idle, we shall have to face the problem of what we wish to sacrifice. And while the choice is one to be made by the people and their Government, as an economist I should point out that if even a relatively small proportion of the budget devoted to military expenditures were reallocated to the investment in capital and education of which I have spoken, the increase in the attainable rate of growth could be large. To those of us who believe that our national security depends as much or more on our ability to grow as on the weight of our armaments this is an insistent issue.

The CHAIRMAN. Thank you very much.

The discussion will be continued by Mr. Joseph Fisher, Associate Director of Resources for the Future.

## STATEMENT OF JOSEPH L. FISHER, ASSOCIATE DIRECTOR AND SECRETARY, RESOURCES FOR THE FUTURE

Mr. FISHER. Thank you.

During the past few years political leaders, businessmen, economists, and many others have become preoccupied with the subject of economic growth. In this hearing, therefore, we are touching the heart and center of what is now thought by many to be most important in economic policy. I should like to make several comments on the measure and meaning of economic growth, and then on some of the factors affecting economic growth.

### THE MEASURE AND MEANING OF ECONOMIC GROWTH

The best single indicator, in my opinion, of the rate of growth is the growth of gross national production per capita. In addition, growth in total GNP, and of the productive capacity which makes it possible, has an independent importance apart from its expression in per capita terms. Military security and striking potentiality depend upon absolute amounts, as well as per capita ratios.

A word about trends of GNP and GNP per capita, population, and production. During the 25 years, 1930–55, the population of the country grew at an average rate of 1.2 percent per annum compounded, GNP increased at an average rate of 3.6 percent, GNP per capita 2.3 percent. Nonagricultural production over this span of years grew at an average annual rate of 3.5 percent, agricultural production, 1.6 percent. GNP per worker during the 25-year period increased at an average annual rate of 2.2 percent, with agricultural product per employed agricultural worker increasing at a considerably greater rate than nonagricultural product per employed worker.

Looking to the future, it may be estimated that during the next 15 or 20 years population may increase at around an annual rate of 1½ percent per annum compounded, with a considerable range of possibilities. Weekly hours of work undoubtedly will decrease gradually in line with past trends, and productivity (output per man-hour) undoubtedly will increase. How much in the latter case is a question of decisive importance. The annual rate of increase in both GNP and GNP per capita has varied considerably from year to year in the past, and no doubt will continue to do so in the future. Whether in the future we will be able to lift the average annual rate is an open question. The simple setting of an objective in terms of GNP growth at, say, 4 percent or even 5 percent a year, while historically the average has been nearer 3 or at most 3½ percent, will surely not of itself guarantee its achievement. A forecaster would be safer, it seems to me, to be guided by historical performance (or perhaps a little better than that), rather than desired goals. In this case, future years, like past years not counting the very poor ones, may well see an average rate of increase in GNP of 3½ to 4 percent and an average rate of annual increase of GNP per capita of a little over 2 percent. Again, considerable ranges are possible, depending upon the precise size of the labor force, the number of hours worked, and the sustained gains in productivity.

Frequently overlooked, but nevertheless of highest importance, is the quality of economic growth, rather than its sheer size or rate of growth. Production of more and more unnecessary things providing more and more jobs and more and more purchasing power will not greatly improve the defense of the country or the character of living—at least from many points of view that are quite relevant. Indeed, too much labor, materials, and managerial ability crowded into unnecessaries would positively subtract from the output and ability to produce things more needed. The much-discussed tail fins do not add appreciably to the strength of the country, nor do patent medicines and cosmetics (including the advertising efforts to sell them) contribute greatly to the improvement of our basic economic position in the world.

## SOME FACTORS AFFECTING ECONOMIC GROWTH

It is easy to list the factors affecting economic growth, but very difficult to appraise their relative degree of influence in different situations. Labor skills and the amount of work done, managerial ability, technology, the relative amount and total amount of the GNP devoted to investment, the richness and variety of natural resources, economic and related institutions—all are factors significant for economic growth. Which one may be critical in the sense of being a bottleneck to growth—or, more accurately, which combination of factors—will depend in subtle ways upon the total situation facing a country at a given time.

For example, over the course of American history, speaking generally, a relative shortage of labor has presented more persistent problems than, for example, any shortage of basic natural resources. For the future, one might speculate that the more critical factors affecting economic growth will include the further education and training of the entire labor force, further improvement in the arts of management, continued and increasingly rapid adaptation of scientific discovery through technology, and larger amounts of GNP devoted to investment.

Important also is a maintenance of a rich and varied flow of raw materials reasonably placed and widely available.

There is one other factor which is probably most important of all in its effect on economic growth—more important than any one or any combination of the more particular factors mentioned already. This may be called the motivation to grow, or the will to grow. Research, technological adaptation, investment, hard work, managerial ability, plentiful natural resources, and all the rest may not prove to be enough to lift the rate of growth of the American economy, if that is what is desired, without a large injection of the motivation to grow. In the past such motivation has come out of crisis, such as the crisis of the Second World War. (The average annual rate of growth of GNP in the period 1940–45 was 8.8 percent, much larger than any other similar length period in recent history.)

In the future greatly increased economic growth might come out of deliberate growth-oriented policies on the part of Government and business of a much more vigorous and far-reaching character than we have had heretofore during peacetime. Or, it may be that the apparently very higher rate of growth of the Soviet economy (in his speech a few days ago Khrushchev indicated the Russian economy was growing and would continue to grow at something like 8.6 percent a year) will frighten this country into a state of mind which will lead to a stepping up of our own rate of growth.

It is perfectly obvious, of course, that if the Russian economy is growing and continues to grow at twice the annual rate of the U.S. economy, it is only a matter of time (and not too long a time at that) before Soviet GNP and industrial production will pass those of this country. Indeed, the Soviet Union may already have passed the United States in the production of certain items of particular importance to war.

Further than that, there exists the very real possibility that, long before the Soviets pass us in absolute size of GNP, they will pass us in a number of basic industries. This they could achieve at the expense of development along other lines, such as a variety of less essential consumer goods and services.

Much is being written these days about the importance of research and development for economic growth and military security. It is impossible for me to see how the importance of R. & D. can be exaggerated. Spending for R. & D. for Government, industry, and the universities and foundations, has been increasing rapidly during recent years. This is all to the good. Somebody said recently that R. & D. expenditures now are almost as high as advertising expenditures. Ten or twelve billion dollars of R. & D. spending out of a total GNP running at about $450 billion a year does not seem extraordinarily high. It is less than 3 percent. Although the total amount is increasing, balance is still lacking.

I agrée with many scientists now writing on the subject that we are relatively short on basic compared to applied research, and on research in the biological and social sciences compared to the physical sciences and engineering.

Undoubtedly, also, there are regional imbalances. For example, additional basic research in the water resources field would be very helpful to the more arid parts of the country. This research might include weather modification, prevention of reservoir evaporation through the use of monomolecular films, elimination of useless water-using plants and trees, desalinization of sea water and brackish water, and transmountain and long-distance transport of water. More broadly, R. & D. on all the basic resources will be necessary in larger amounts if tendencies toward increasing costs of lumber, copper, oil and gas, and other products are to be held in check.

The very significant question has been raised, can we count on the contribution of these growth factors to continue in at least the same degree as in the past?

A quick and probably superficial answer might be, "Yes, we can in all likelihood assuming the trends, some might say drift, of past policy relevant to economic growth also continues."

This first question almost of itself asks another: will a continuation of past rates of growth be adequate for the problems of the future? To this question I am inclined to answer in two ways.

First I think we would be running grave risks in military terms and in terms of our total position vis-a-vis other countries in the world if we did not establish as the goal of national policy an average annual growth rate somewhat above the historical average. A 4-percent growth rate would require us to reach somewhat beyond what we have been doing on the average in recent years, but the reach is not so great that we should not be able to achieve it. A 5-percent growth rate in many respects would serve better as a goal or target, but by the same token, may be unrealistic in terms of what can be done, at least in the immediate years ahead.

The second part of my answer to the question I believe is the more important part. This is that the quality and components of economic growth, whatever rate may be set as the goal, are more important than the overall amount, or at least equally important. Here, as a matter of my own preference and belief, I come down solidly on the side of those who argue for more and better social capital, in the form of schools, health facilities, basic natural resource developments, transportation improvements, vocational rehabilitation and training, and social welfare in the broad sense. I come down also on the side of those who argue that within fairly broad ranges we can afford and must provide the defense facilities and equipment deemed to be necessary for our own defense and for the military and economic support of friendly countries. Within the United States policies designed to foster expansion of basic, growth-producing industries can be favored.

My reasons for these preferences obviously are not entirely, or even mainly, of an economic nature. But I do argue that it is the business of the economist in a meeting of this sort not to shrink from stating his policy preferences, especially when he thinks, as I do, that they can be accommodated economically. All of this, of course, means higher expenditures at the various levels of the Government and, inevitably, higher taxes if inflationary effects are to be contained. The relative shift in emphasis toward social and perhaps defense capital and toward growth-producing industries implies a shift in emphasis away from consumer goods and services, at least in the shorter run, toward investment goods which support and make possible the building of schools, hospitals, dams, military security, and basic industry.

We have, therefore, not only the problem of stating our objective in terms of a higher rate of overall economic growth, but also the problem of stating our objectives in terms of shifts of emphasis within the total. Here we really tread on many toes. Any major shifting of emphasis in the way we compose our GNP and use it will be difficult and will have to be worked on in different ways. Partly it is a matter of seeing the dangers in present trends and taking action to prevent them, partly it is a matter of the slow process of education and the change of attitudes and values, but most important, it is a matter of inching forward through more appropriate policies.

Representative REUSS (presiding). Mr. Fisher, thank you very much.

The next panelist will be Prof. Daniel Hamberg of the University of Maryland. Professor Hamberg?

## STATEMENT OF DANIEL HAMBERG, PROFESSOR OF ECONOMICS, UNIVERSITY OF MARYLAND

Mr. HAMBERG. Thank you, Mr. Chairman.

In the brief time at my disposal, I should like to address my opening remarks to the question of research and development. Specifically, I should like to draw the committee's attention to our great ignorance on this subject, to possibly erroneous views relating to it, and to important issues of public policy bearing on this vital topic.

Obviously, research and development are crucial factors in economic growth. Over the long haul, they are the ultimate source of new processes and new products. To the extent that new techniques permit lower costs of production by enabling us to produce more with given resources, they enable the national product to grow faster than the rate permitted by the growth in labor supply and capital stock. In this way, they allow a faster growth in per capita income than would otherwise be possible. If inventions take the form of new consumer products, they may reduce the burden of household chores, maintain or even raise our incentives to work, thereby resulting in a higher labor force participation rate, the holding of dual jobs, et cetera, with further advantageous effects on the growth of the national product, total and per capita.

There are countless other ways in which inventions affect our lives and livelihoods. In recent years, great stress has been laid upon the importance of finding ways of raising the rate of technical progress for reasons relating to both foreign and domestic policy. Implicit in this view are suggestions that technical progress may indeed be an object for policy and organization.

Yet, notwithstanding the critical importance of technical progress, it is one of the least understood, and until very recently one of the least studied, subjects. Take the matter of invention (as opposed to innovation), for example, since this topic embraces the question of research and development. Who is doing the inventing? What are they inventing? Why? How? What are the sources of finance? What is the influence of size? What are the advantages and disadvantages of organized and individual research? What prompts some firms to be interested in research and other firms to be disinterested? What has been the impact of various aspects of Government policies bearing on inventions? On these and a host of related questions, there is little or no information.

But this ignorance has not prevented us from forming some very hard and fast ideas about the origins of recent inventions, ideas that have been reflected in important areas of public policy bearing on this crucial matter. Again, let me take one important case in point.

With the aid of an exceedingly skillful and elaborate advertising campaign, business management has succeeded in persuading the general public, "expert" and otherwise, that the large corporations have become the cradle of inventions. Only these great firms, it is said, possess the resources to finance the skilled teams of scientists and engineers, working in splendidly equipped laboratories, that are now the providers of new production methods and new products. Small and medium size firms are reputed to be losing out in this process, and the individual inventor is said to have become as obsolete as the proverbial one-horse shay.

How accurate a description of reality does this widespread view represent? And if correct, how desirable is such a development? By way of answering the first question, let me make brief reference to the results of some recent research and other sources of information.

A recent study of 61 important inventions that occurred largely, but by no means exclusively, between 1900 and 1940, and chosen without previous knowledge of origin, revealed that two-thirds were the product of the research of individual inventors (who were responsible for over half of the 61) and relatively small firms. Among these were such diverse inventions as air conditioning, automatic transmissions, catalytic cracking of petroleum, terylene, the cotton picker, the jet engine, the ballpoint pen, continuous casting and hot strip rolling of steel.

Another recent study of a random sample of patentees disclosed that between 40 and 60 percent of the patentees could, by virtue of occupational or educational status, be said to have worked outside the organized teams of the industrial laboratories. This evidence is enough to cast serious doubt on the belief that invention is now the bailiwick of the great industrial laboratories.

It might also be well to note a few figures on research expenditures to gain some perspective on the sources of finance. In 1957 out of a total of some $9 billion spent on research and development (including $3 billion of Federal spending on missile development and testing), only one-third was supplied by private sources; the remaining two-thirds was supplied by the Federal Government for research and development for defense purposes both within and without the public sector. This information seems to indicate that the prodigious increases in corporate research and development spending since 1940, about which so much has been heard, have been largely the result of Government financing for defense reasons.

The same information also explains why over half of private research activity (as opposed to spending) is concentrated in a relatively few defense-connected industries, like aircraft, electronic and electric equipment, and atomic energy. In other words, most manufacturing industries and firms have not shared in the spectacular growth in spending on research and development. In fact other data show that most manufacturing firms, large and small, carry on very little of this activity; they concentrate on manufacturing.

Nor should this information be very surprising. The chemical and petroleum refining industries are virtually the only ones where heavy outlays on unsubsidized research are common.

In contrast, the list of industries dominated by very large firms where interest in research has traditionally been at a minimum is impressive by its length and character. The steel industry is a notable case in point. Since the turn of the century, this industry (particularly the largest firms) has not been noted for its progressiveness, and the biggest firm, United States Steel, has been notorious for its lack of interest in research.

Virtually all the important advances in the methods of producing primary steel have come from outside the industry, or from small firms within the industry. But there is no need to dwell on the steel industry. It has been said of the cigarette industry, dominated by a few large firms, that its members are almost totally innocent of any serious interest in research. In the equally concentrated auto industry, it is fair to say that most of the recent engineering improvements have come from outside the large firms of this industry. Many, like the new suspension systems, were pioneered by small European concerns, and others, like the automatic transmissions and power steering, were largely the results of the work of individual inventors.

The list of industries where relatively little is spent on research could be extended from the basic metals industries generally through the food products and agricultural machinery industries, both dominated by very large firms, to such other concentrated industries as plumbing equipment, linoleum, and meat products.

I have set forth the foregoing information by way of raising serious doubts that the great industrial laboratories are now the respositories of research and invention that they have been made out to be and to caution against the glib tendency to identify large firms with serious research interests. By itself, the perversion of reality that has been instilled in the public mind might be rather harmless. But, unfortunately, it has come to be reflected in official attitudes and policies.

Whether by design, or chance, or even administrative expediency, public policies bearing on the inventive process have had the effect of promoting the institutionalization of invention in the large industrial laboratories.

Implicity or explicitly, these policies assume that large teams of organized scientists and technicians working under close administrative guidance, with their tasks and goals carefully preestablished, are indeed the best approach to invention. But it certainly remains to be established that there is a definite correlation between size of research organization and quality as well as quantity of inventive achievement.

On the contrary, it is disquieting to hear of the number of research administrators who remark on the amount of piddling that goes on in the great laboratories and the heavy spending on marginal improvements designed to maintain patent controls. And students of inventions have often commented on the number of truly important inventions that have been the work of individuals unassociated with an industry and thereby able to approach its problems with a completely fresh and detached outlook.

Thoughtful persons will wonder how much is lost in the way of inventive achievement when technical personnel are no longer free to follow their own bents and hunches, but instead are tied to posts erected by others. How much is lost in originality, in the quest for novel ideas, and novel aspects of old ones, as large research groups and institutions grow rigid in organization and outlook under the impact of increasing centralization of control, administrative and financial? And under such conditions how much resistance is offered to ideas originating elsewhere and outside the accepted modes of thought?

These are all important questions that appear to have been overlooked in the efforts to encourage institutionalized research. Equally important, we actually don't know what the answers to these questions and those raised earlier are, because so little research in the area of research and development has been done.

Representative REUSS. Thank you, Mr. Hamberg.

Mr. Heymann, Jr., of the Rand Corp.

## STATEMENT OF HANS HEYMANN, JR., ECONOMICS RESEARCH STAFF, THE RAND CORP., WASHINGTON, D.C.

Mr. HEYMANN. I have been asked to discuss Soviet economic growth, and I am not at all sure that my topic is relevant to the subject matter to be discussed by this panel, but I am sure that the fact of continued rapid Soviet economic growth deserves the attention of this committee, and so I am only too glad to comment briefly on it.

The main points I wish to make can be summarized in three sentences:

(1) The Soviet economy in the past 7 years has been expanding at a much faster rate than the U.S. economy and, in spite of visible slowdown tendencies, it persists in a pattern of resource allocation that is highly conducive to further rapid growth in the next 7 years.

(2) The Soviet leadership has made an international symbol out of its ambition to surpass the United States in per capita production by 1970 and, even though the Soviet economy will almost certainly fall short of this goal, the spectacle of continued uninterrupted Soviet economic progress is bound to exercise fascination and appeal in many parts of the world.

(3) While Soviet total output will continue for many years to lag behind that of the United States, it is well to remember that national power does not rest on total output, but on a nation's willingness and skill in using its output to support its policy objectives; in this sphere the Soviet regime enjoys advantages which even today have frightening implications for U.S. security.

Let me amplify each of these points briefly.

First, the rate of economic expansion: There seems to be now a substantial consensus among western economists that the Soviet rate of industrial growth in recent years has been much more rapid that that experienced by the leading Western Powers. One very careful recent comparison of Soviet and United States industrial output for the period 1950–57 shows that, in the field of industrial materials, the Soviet economy during that period achieved an average annual rate of growth 4½ to 5 times as high as that in the United States. Other independent estimates show that Soviet industrial output since 1950 has been expanding at a rate between 9 and 11 percent per annum.

There is no miracle or mystery about the speed of this expansion. It rests basically on the regime's centralized direction and authoritarian control of the nation's resources. The time-tested mechanism by which the economic gains are achieved includes a forced high rate of capital investment, a structure of investment that favors the growth-producing industries, and a continuous influx of new labor to feed the manpower appetites of the growing industries.

Now in recent years some slowdown tendencies have become evident in the Soviet rate of expansion. In part these can be explained in terms of temporary bottlenecks resulting from bad planning; in part, however, they appear to reflect more permanent changes associated with growing economic maturity and declining labor supply. In any case, Khrushchev, under his new 7-year plan, has had to accept a somewhat lower rate of growth than heretofore. But it would be a mistake to make too much of this retardation. The factors causing it do not add up to a critical weakness in the Soviet economy, and we must expect further respectable rates of economic growth exceeding those likely to be achieved in the free world.

A word may be in order concerning Khrushchev's keynote slogan of catching up with America in per capita production by 1970. It seems to me that this propagandistic objective, for all its bravado, deserves to be taken seriously, but not literally. By that I mean that it is most unlikely that the Soviet economy will in fact achieve parity of output anywhere near 1970, but that this is beside the point. In this competition it is not the timing that counts, but the relative trends. It is not the sudden tipping of the scales, but the gradual and progressive erosion of U.S. superiorities one by one that would tend to be most demoralizing to the West and most welcome to the Soviet leaders. For this they may not have to wait till 1970. In all likelihood, even by 1965 the Soviet output of many basic raw materials and industrial products will at least approach and may well exceed that of the United States, and while this is not significant in itself, it would be sufficient to persuade many that the Soviet economy has attained the coveted position alongside the United States in the very front rank of the world's great industrial powers. The spectacle of a Soviet economy successfully pursuing rapid economic growth with a sense of utmost urgency is bound to have a magnetic attraction for the vast parts of the world where rapid economic development has become virtually a prerequisite to political survival.

Finally, I should like merely to observe that "growing" or "staying ahead" in total output is only one objective; from the national policy point of view it may not be the most important objective. A superior level of output may be desirable for a variety of reasons, but it does not automatically denote national power. A superior U.S. output capacity is important only to the extent that it is effectively enlisted to serve the national interest. In other words, national power does not rest on total output, but on the efficiency and consistency with which the Nation is able to use its output to advance its policy objectives. In this respect the Soviet Union, with its overwhelming centralized direction of resources, has distinct advantages which tend to offset its inferior resource base. With an output capacity a good deal less than half of ours, the Soviet leaders still manage to divert such a large proportion of their resources steadily, year after year, to their national aims that, in at least two important areas, they have essentially achieved parity with us already: in the ability to cancel out much of our military power, and in the ability to use their economic resources abroad as an effective instrument of foreign policy. Clearly, the challenge of Soviet economic growth does not lie in the distinct future.

Representative REUSS. Thank you, Mr. Heymann.

Would you identify for the record just what the Rand Corp. is?

Mr. HEYMANN. The Rand Corp. is a private nonprofit organization engaged in a program of research and study primarily on problems of national defense for the U.S. Government. I should like the record to show, however, that I am here speaking only for myself and that my testimony does not necessarily reflect the views of the Rand Corp. or of any agency with which it is associated.

Representative REUSS. Thank you.

Mr. Robert E. Johnson of West Electric Co.

## STATEMENT OF ROBERT E. JOHNSON, ECONOMIST AND ACTUARY, WESTERN ELECTRIC CO., INC.

Mr. JOHNSON. Thank you, Mr. Chairman.

The present standard of living of the American people is a monument to the research and development of the past. Every projection

I have seen of the future of the American economy—and there are many—contemplates further increases in the output per man-hour.

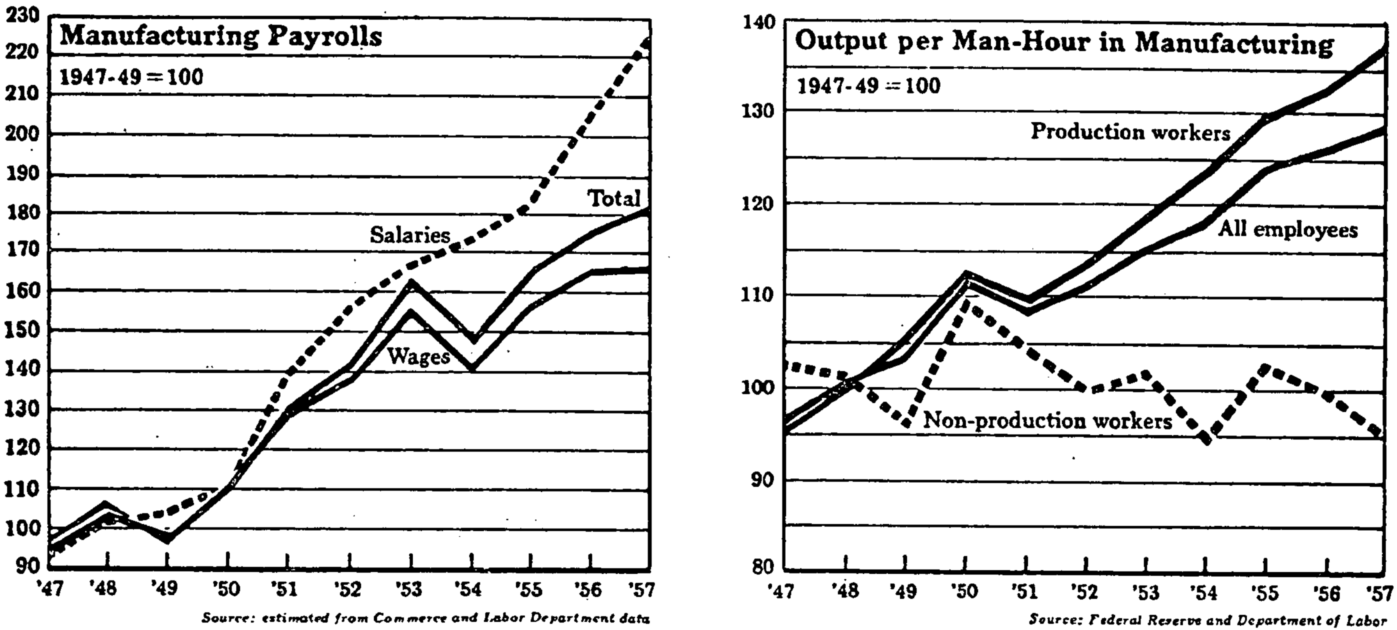
This follows from the ever-increasing emphasis on research and development. As Sumner Slichter brought out last May in his talk before the National Science Foundation's Conference on Research and Development and Its Impact on the Economy, it has become an industry—I suspect a $10 to $12 billion industry. Research and development today is an organized effort to pierce the frontiers of knowledge which, for the most part, tends to be concentrated on particular problems in the physical and engineering sciences designed to achieve specific end results.

Incredible advances have thus been made in the improvement of the well-being of the American people, with the result that as a nation we are better fed, better housed, and better clothed, yet with more leisure and less effort than recorded history has even known.

Concurrently with the ever-increasing complexity of the American economy, there has been a lag in research in the nonphysical applications, perhaps understandably, since the major emphasis has been placed on the physical applications. This is illustrated by the attached chart published in the June 1958 issue of Fortune magazine, developed from data prepared by the Federal Reserve Board and the Departments of Commerce and Labor, which clearly brings out in the left-hand graph the disproportionate growth in salaries as compared to wages. The right-hand side of the chart brings out the increased output per man-hour of production workers compared with the stability of output of the nonproduction workers.

(The chart referred to follows:)

## Productivity and the Non-Production Worker



Mr. Johnson. Hence, research in this nonphysical area may well contribute greatly to the increase in productivity over the next decade. Military research in computer hardware and the mathematical solution of different problems has stimulated many of us in business to explore these tools for their potential use in improving the logistics side of business. Although the operational problems involved are most complex, we are now beginning to visualize the significant potential that these tools have in solving many problems with a resultant reduction of the cost in the logistics area.

Work which we, at Western Electric, have done using the mathematical techniques of linear programing has reduced transportation costs up to 30 percent in one case. The use of this tool has aided in the selection of new plant sites by providing evaluated transportation costs for alternative locations. Similarly, the allocation of products as among various plants has been achieved so as to minimize transportation costs.

The use of mathematical formulations and computer techniques in the areas of inventory requirements, economic production runs, and production scheduling have in some cases reduced inventories, in other cases the costs of setups have been reduced. These savings have contributed to reduced costs and improved productivity. Simultaneously, such techniques have stabilized both production and inventories while adapting to dynamic changes in demand.

Scientific sampling techniques have been tested in auditing, quality control, and a number of other areas. While maintaining the quality of the function, cost reductions of as much as 50 percent have been realized.

We have experimented with these mathematical tools in many other areas, such as maintenance of plant facilities, forecasts of sales, lost-time accident improvement, et cetera. We see the possibility of increasing areas of usefulness as we gain more experience with these tools. Considerable basic research will be needed to gain the full potential benefits.

Looking to the economy of the country in the aggregate, to the extent that these nonproduction costs can be reduced productivity will be increased. To the extent that these tools will aid in recognizing sooner the swings of the business cycle, thereby advancing the timing of the contracyclical measures by millions of American businesses, we may reduce the amplitude of the business cycle and its waste of resources.

Let me comment briefly on the potential impact on employment. Although any increase in output per man-hour decreases the demand for labor to produce the same volume of goods and services two considerations may be worth noting:

First, the results of research and development do not have a sudden impact. There are just not enough trained people in this field to do everything at once. Hence, the results will trickle into the economy even with the most optimistic concepts of achievement.

Second, in the long run we have every reason to anticipate that the benefits will be distributed in three ways:

(*a*) We may expect research and development to continue to produce new kinds of goods and services which in turn will create new sources of employment and higher standards of living.

(*b*) We may expect that many present goods and services will be cheaper relative to consumer incomes, thus permitting the satisfaction of more wants of consumers, and thereby further increasing the standard of living.

(*c*) We may expect some of the increase in output per man-hour to result in fewer hours of work per lifetime in the form of more holidays, more vacations, more education, and longer retirement.

Representative REUSS. Thank you, Mr. Johnson.

Mr. Herbert E. Striner, economist at the Johns Hopkins University.

## STATEMENT OF HERBERT E. STRINER, OPERATIONS RESEARCH OFFICE, JOHNS HOPKINS UNIVERSITY

Mr. STRINER. Mr. Chairman, I want to thank you for the opportunity you have given me to discuss with you some of the problems which exist with respect to regional economic analysis, as well as the importance of this type of analysis in any inquiry pertaining to national economic growth and development. Allow me to start with this second point first.

To begin with, I should define the term "region." As you probably know, given four people who are asked for such a definition, you are likely to get at least four different answers. For our purposes, however, let us accept as a region any identifiable geographical area, whether a county, river basin, city, State, or combination of such units. In reality, the area will make sense only when we know what type of question we are dealing with.

Now, national economic growth, no matter how growth is defined, must always be the sum total of the growth and development of the components parts—or regions. National economic growth is advanced or retarded as our regions progress or stagnate economically. To obtain maximum regional economic growth and development, it would seem to me that several facts of life must be recognized and faced up to, whether they be pleasant or not. To begin with, while we all recognize the fact that this is a dynamic world in which we live, and this is a continuously changing economic and social scene, we often seem to avert our eyes from this same reality when specific regions are involved.

When regions or communities are threatened by such problems as import competition, changes in taste or domestic demand for local products, the shift of population to other areas, the tendency is usually to attempt to maintain the situation as it had existed up to that point. However, given the everchanging nature of the types and magnitudes of demands for goods and services, a region must always hold itself ready to alter its patterns of thought about what it can produce and sell with greatest benefits to itself.

It is important to recognize the fact that change is always with us, and can serve as well if we are sufficiently flexible and are ready to revamp and redevelop our regional economies in a manner best calculated to get the most from our resources. Not to do so frequently means subsidizing outmoded and costly production techniques, low-grade and costly raw materials, and uneconomical uses of resources, human and otherwise, which could be highly productive.

Federal policy should seek to aid or stimulate regions to know themselves better, and view themselves as collections of resources probably capable of satisfying many different types of demand. Catalysts and incentives should be provided to undertake such appraisals, or reappraisals, as various types of situations may determine. And this is applicable not only in the case of depressed areas and newly developing areas, but also in those areas which, though not depressed, may still desire to use their resources in such a manner as to maximize their economic growth. I would stress this latter type of situation with this committee. In the last Congress there were introduced various area development bills.

I believe the chairman, Mr. Douglas, is in the process of doing so now.

All were standard in their approach, that is to say, they sought to help communities which, according to specific criteria, qualified as depressed areas.

I would submit that more important gains in economic growth and development of our national economy may result from a policy which seeks to provide incentives to all communities to maintain a flexible and dynamic attitude with respect to new markets, new development, and new community enterprises which can increase the rate of growth of the area.

The incentives may consist largely of relatively inexpensive, though highly expert, advice on planning, marketing, resources development and allocation, and a whole host of similar factors affecting development and growth.

Federal policy thus far has not envisioned this broader program to provide advisory, consultative, and perhaps some investment aid to forward-looking communities which want to increase their rate of development but lack the proper degree of depressed circumstances to qualify.

The second point I wish to discuss this morning has to do with problems of regional economic analysis. Let me dwell on the chief problem—relevant economic data for regions.

Your committee has in the past indicated the great need for regional statistics. I cannot sufficiently emphasize the importance of this position. Regions are hampered in many types of analysis or self-evaluation because of the lack of up to date, sufficiently detailed statistics concerning the area. Communities which have increasingly become interested in the possibilities of well-designed development of their resources and promotion of profitable trade relations are frequently frustrated at the very outset by the sparseness of timely, detailed regional data.

I might add that in industry, numerous companies are adversely affected in their ability to undertake market analysis, production scheduling, materials purchases, and investment programing because of the lack of regional economic data. These companies frequently feel the effects of regional shifts in demand or supplier costs before they are able to take account of these changes in their plans. More detailed and timely regional data could be of importance in preventing various situations which impair the use of our national economic capacity and hinder economic growth.

In conclusion, I would be happy to further detail this very general statement should members of the committee so desire.

Thank you, gentlemen.

Representative REUSS. Thank you, Mr. Striner.

The last panelist is Mr. Alan T. Waterman, Director of the National Science Foundation.

## STATEMENT OF ALAN T. WATERMAN, DIRECTOR, NATIONAL SCIENCE FOUNDATION

Mr. WATERMAN. Mr. Chairman, I shall only summarize some of the highlights in my statement because it is very long.

I want to begin by saying that I am not an economist. I am a scientist and administrator of science so that what I shall have to say will deal with the relations between science and the economic strength of the country.

In the first place, it is not usually understood that science is at the beginning of these things and what we are really talking about in the effect on the economy is technology.

Science is a study that gives us a knowledge of man and the universe and when we understand these things we can then begin to apply them. Technology goes from basic research, then, which is the province of science, into applied research, which is commonly understood, and then development, test, and production, sales, and distribution.

The whole thing, technology, is really what affects the economy.

Now, the first, basic research, is apt to be misunderstood. It is a vague thing and the important thing, it seems to me under present economic conditions—and some of the other speakers at this table have mentioned this—is that basic research is apt to receive less attention, particularly in times of stress when there are many things that need to be done at once. Part of that reason is an inadequate understanding of what basic research really is.

I might illustrate by some cases.

In the first place, there are different types of basic research. Take the research that led to the transistor. That was a deliberately planned piece of basic research. The Bell Telephone Laboratories devoted 5 years to basic research to understand how certain materials transmitted electricity, poor conductors of electricity. After that understanding they could then make the development.

Another illustration which is quite different is the discovery of X-rays which could not have been looked for because no one knew they existed. Therefore, you might say this discovery was made by accident, due to a very keen investigator looking at discharge of electricity through a tube filled with air at low pressures.

Still another type was the use of imaginary mathematical quantities. At the time, even mathematicians could see no utility in this whatever. Now, today, every research engineer has to know how to use imaginary quantities to do his job effectively.

Perhaps a more dramatic case is the story of helium. Helium was discovered as a gas in the sun back in the last century by a man who was only trying to find out what the sun was made of. It was not known to exist on the earth. This was, therefore, very basic research.

For a long time we did not know it existed on the earth but just before the turn of the century, it was discovered to exist in a very tiny amount in the atmosphere. For a long time it was peculiar because no one could succeed in making it a liquid as with other gases. Finally, this was done in a laboratory and in the process proved to come closer to the lowest possible temperature, absolute zero, than any other method—only 4° C. away from absolute zero.

The effect of that in research was astonishing because it was found that when you cooled liquid helium to about 2° from absolute zero, it had some astonishing properties.

At this temperature metals like lead and tin became superconductors of electricity. That is to say they had no resistance, apparently, to the flow of electricity in them. You can imagine the interest this caused.

The great cost in our electrical power problems is in the transmission line due to the resistance of the line. If we could find out how these metals conduct electricity perfectly at such temperatures and apply that to transmission lines, at ordinary temperatures there would be an enormous saving.

A variety of liquid helium, within 2° of absolute zero, seems to have extraordinary properties in connection with conduction of heat. It is 10 times better than copper or silver. If we could find out what causes this we could improve materials in the same ratio, perhaps, at ordinary temperatures.

Finally, this variety of liquid helium flows almost without friction. It is a perfect fluid. You can take a little tube of air and put it under high pressure, make a hole in the tube so small that it takes several hours for only, say, 10 percent to come out the hole and then, if you put this liquid helium in it under no pressure but its own weight, it comes out in a few seconds. In other words, it flows with almost the absence of friction.

If we could find out why this is true, we might improve the properties at ordinary temperatures. We have not done so, but my point is, these are inviting possibilities and, if we could learn how liquid helium does these things, you can imagine the effect on industrial applications.

This is a case where we have no answer yet but it illustrates some of the important features of basic research.

Now, helium itself has other uses, as you know, for balloons and for shielded welding and other uses which are incidental and important. The supply is limited, by the way, in this country and the Department of Interior presented a bill to Congress last year to conserve its supply.

Incidentally, helium is the only means we know to get that close to absolute zero, so that if we lose it we lose the opportunity to do basic research at these very low temperatures, and lose further opportunity to understand these remarkable phenomena.

To go back to the broader theme, what technology has to say about the economy in the first place, as everyone understands fairly well, is that we would like to see the avoidance of wastage; for example, by attempts to develop things prematurely or inefficiently.

A good illustration where this enters is if one is forced to do a crash program. As industry knows, this is far from an efficient way to do things. This can be avoided simply by doing more research ahead of time so that basic research and research in general is very much needed in long-range planning in technology.

Second, we should develop our full potentialities with respect to technology. This means exploring all the possibilities in research that we have competent manpower to engage in the work. Funds required for such research are relatively very small.

Finally, we should concentrate on essential developments as far as possible. We should establish priorities for developments to be undertaken, and that is a very troublesome thing as industry well knows. Industry, of course, knows this technique extremely well.

Where I would come out then in the situation where one wants to keep the economic strength of the country strong and at the same time protect the national security and all that goes with that is as follows. The logical thing, it seems to me, is that we must bend every effort to discover the possibilities of science. This is done through basic research.

Incidentally, by doing that, we train scientists and engineers because they all must use basic research to get their training. The logical place for this, of course, is the universities.

Having discovered the full possibilities, then to keep the economy strong and not run that in jeopardy, one has to make a selection of what are the high priority developments to undertake. To a scientist it looks that simple.

I know that the process of achieving it is not simple but in principle this logic seems sound.

Above all, what we must aim for, broadening the scope still more, is quality: quality in the discovery and use of our resources; quality in the training of our people for science or any other thing; and finally quality in their performance, seeing they have the things they need and are ready to work. So that, in the last analysis, if one were to make a single slogan for the economic strength of the country, I would say it is to cultivate an atmosphere whereby every individual develops his talents to the fullest. Everyone who does that will not only have a more rewarding career and a happier career, but he does a service to his country and to the world.

(Mr. Waterman's complete statement follows:)

STATEMENT OF ALAN T. WATERMAN, DIRECTOR, NATIONAL SCIENCE FOUNDATION

Mr. Chairman, members of the Joint Economic Committee, I am happy to have the opportunity to meet with you here today and to discuss with you some matters of mutual interest. All of you, I am sure, are aware of the fact that I appear before you as a scientist and science administrator—certainly not as an economist, for I can claim no expert knowledge in that field. Nevertheless, I feel that scientists and economists have a great deal to say to each other and that the national welfare is fostered by a deeper understanding on both sides. One of the special features of our time is the increasing extent to which the areas of national interest bear one upon the other. I believe the modern view of history is that it is not realistic to sort into discrete categories political, economic, sociological, and technological factors, and today we seem to realize, as never before, perhaps, how closely these elements are interrelated.

The National Science Foundation, as you know, was established by Congress 9 years ago. Along with other functions it was directed "to appraise the impact of research upon industrial development and upon the general welfare." Congress thus clearly identified research and development with the national welfare.

Our principal efforts are directed toward the support and encouragement of basic research and education in the sciences, but we are also concerned with the measurement of research and development in its relation to the overall economy. We have assigned to a special staff the task of gathering and analyzing a wide variety of data pertaining to the total research and development effort in the United States.

More and more emphasis is being given to research and development in the analysis of long-term growth as compared to the somewhat more traditional factors, particularly capital expenditures and population. The 1959 Economic Report of the President has called attention to the extremely important role that research and development contributes to the growth of the economy. The Committee for Economic Development in its report on "Economic Growth in the United States" gives prominence to the forces of "technical change and advancement." It is also significant that investment analysts lay stress on the research activities of individual companies as an indication of past and potential growth.

Prof. Sumner Slichter, in an address prepared for an NSF Conference on Research and Development and Its Impact on the Economy, stressed the economic significance of research:

"Technological research has three characteristics that give it far-reaching economic significance. The first of these characteristics is that it greatly increase the capacity of the economy to raise the demand for goods. It is obvious that technological research increases the capacity of the economy to raise productivity. Less obvious and indeed generally overlooked is the fact that research gives the economy the capacity to bring about planned increases in the demand for goods—both by creating new demands for consumption goods and by creating new investment opportunities."

In decribing the part of technological research that can be carried on for profit, Professor Slichter coined a particularly happy phrase. He called it the "industry of discovery."

Certainly, when we examine the magnitude of growth of research and development in the United States, it is apparent that it has indeed assumed the dimensions of an industry.

Our studies indicate that the national research and development effort currently stands somewhat above $10 billion. Despite the decrease in the value of the dollar, this figure is in striking contrast to the annual rate of less than half a billion dollars being spent for research and development before World War II. The rate of growth is dramatically illustrated by the fatc that the figure has doubled since 1953, when the total stood at $5.4 billion.

I do not wish to burden you with figures, but I believe it is germane to this discussion to examine the relative apportionment the research and development effort has among industry, government, and universities and other nonprofit organizations. In terms of performance—that is the sector by which the research and development is being done—industry accounts for approximately 70 percent, government about 20 percent, and the universities and other nonprofit institutions for the remainder.

In terms of support—that is the sources from which funds for research and development are derived—Government finances somewhat more, and industry somewhat less, than half the total, with the universities and other nonprofit institutions accounting for a relatively small remainder.

Let us turn now to a brief analysis of the economic implications of research and development. I should like to stress that these are more significant in a long-run perspective than for the short run. Research and development requires long-range planning just as capital expenditures require such planning. The long-range aspect was emphasized during the recent recession when research and development expenditures increased in contrast to capital expenditures, which decreased.

It is recognized that research and development creates new products, and in turn new demands and new capital expenditures. Increased productivity is brought about by improved processes, and this serves to enlarge per capita income and to counteract inflationary effects in the economy by bringing about a lower cost per unit of production.

Organized labor is actively, and quite properly, concerned lest automation and the growth of mechanized processes result in widespread unemployment. We cannot say that such fears are groundless, but the overwhelming evidence of history is that new laborsaving devices ultimately create new industries, new investment opportunities, and new employment. Organized labor realizes that the industry of discovery leads to new products, and will, in many cases, open up new employment opportunities. If the period of transition to these new jobs is managed wisely, there is little reason to fear technological unemployment. However, as technology develops, more and more of the present-day human chores will be taken over by machines. This leaves us with two choices for the future: a continuing reduction in the workweek and more leisure, or a continued striving for higher productivity and even higher standards of living. The latter objective should be encouraged.

Research and development has the added virtue of producing a leavening effect. Thus the results of research in one industry may help to increase production not only within its own ranks but in other industries as well. A good example of this is the electronic computer. Since World War II its uses have grown and multiplied until now, in addition to its use as a research tool, it is also to be found in a wide variety of industrial and commercial uses.

It is significant that industries with a high growth factor are, in most cases, the highest in relation to the percentage of total expenditures devoted to research. The pharmaceutical industry with its constant stream of new drugs is a prime example of a growth industry. Drugs and medicines research and development expenditures average 7 percent of sales, but some of the firms in this industry have ratios as high as 15 precent. The electrical equipment industry devotes an average 6 percent of every sales dollar to research and development while the professional and scientific instruments industries average 5 percent.

Although it is obvious that research and development bears a direct relationship to the growth of individual companies, explicit data to support this conclusion are lacking. The Foundation is therefore sponsoring a detailed study of this subject, being carried on by the Case Institute of Technology.

The beneficial effects of research and development upon the economy are such that even the millions of dollars expended annually on military research and development ultimately have an impact on the civilian economy. One may cite as the most obvious examples some of the fruits of World War II research, such as the immense electronics industry, the rapidly developing use of jet aircraft for civilian travel, and such important medical discoveries as penicillin and DDT. In a recent telecast, Professor Slichter went so far as to say that—[1]

"Well, I wonder whether the long cold war is a net burden or not. In a sense, it is. If we didn't have to spend this money on defense, we'd spend it on consumption. But many of these defense expenditures are research expenditures and exhilarate the technological development. Certainly, the cold war is bringing faster technological change, faster increases in productivity than would otherwise have occurred. One could make a pretty good case for the proposition that the cold war has paid for itself."

In considering the influence of research and development upon the economy, we must also bear in mind the extent to which research and development helps to stimulate primitive and underdeveloped economies of other nations. Our postwar foreign policy has been distinguished by the clear recognition that economic health is a necessary concomitant to political stability and the encouragement of democracy.

As President Frondizi of Argentina recently stated in his eloquent address to Congress:[2]

"Without national development no welfare or progress can exist. When there is misery and backwardness in a country not only freedom and democracy are doomed but even national sovereignty is in jeopardy. The Latin-American peoples must face this truth, and attack the very roots of the evil. To this end, they must change an economic structure that has become a factor of stagnation and poverty. Our countries must decide, therefore, to make use of all their resources, to mobilize all the available energy, and to take advantage of all the technical and scientific progress of our time.

* * * * * * *

"It is a problem that fundamentally concerns us, the Latin Americans, but from which the United States cannot stand aloof. You cannot remain indifferent to the fact that millions of individuals lead a life of hardship in the American Continent."

A recent study by the Committee for Economic Development is of interest in this context. Fifty scholars and leaders in public affairs throughout the world were invited to submit essays on "The Most Important Economic Problem to be

[1] "Where We Stand II," CBS-Television network broadcast, Sunday, Jan. 4, 1959, from 4 to 5 p.m. e.s.t.
[2] New York Times, Jan. 22, 1959.

Faced by the United States in the Next Twenty Years." Although these scholars represent a wide spectrum of economic and political philosophy, the majority agreed upon two important points:

(1) That the long-term economic growth of the United States would continue, and (2) that the most important economic problem confronting the United States is the problem of the underdeveloped nations of the free world. One contributor to this study, A. K. Cairncross, of the University of Glasgow, declared: "The greatest economic problem facing the United States is not how she can raise her own standard of living but how she can harmonize her economic development with the worldwide process of growth."

Thus, the future holds two great challenges: the ever-growing opportunity to achieve our own potentials for growth and expansion; and the urgent need to assist and cooperate with the great underdeveloped countries of the world at the threshold of their own eras of industrial development. In both these areas, research and development is one of the key factors.

As far as the underdeveloped countries are concerned, technology holds further potentialities: new methods for producing food, power, and consumer goods in areas where conventional methods are unadapted or impractical. For example, although it may be uneconomic to produce electricity from atomic energy or solar energy in this country for the foreseeable future, these methods may prove eminently practical at a much earlier time for nations such as India, where conventional power sources are limited.

In a recent public plea for increased economic aid to the underdeveloped nations to be made available multilaterally, Mr. Paul G. Hoffman pointed out: "* * * that the underdeveloped countries offer the largest potential consumers' market in the world. They are spending twice as much on our goods as they did at the end of World War II and five times as much as in 1938. As they develop, so will their purchasing power and our exports."

Thus far, gentlemen, I have been talking largely in terms of applied research and technology. But as you know, my principal concern is for the proper support and encouragement of basic research, that deep well of ideas into which we are constantly dipping for material that can be exploited and put to practical use. The well is in danger of running dry unless we are careful to see that it is fed by a vast network of life-giving streams. For years, those of us who have been concerned with the research activities of our colleges and universities have pleaded for more support for academic research, both as an intellectual resource and as the basis for applied science and technology. The National Science Foundation was set up to provide a focal point within the Federal Government for such efforts. Now the support of basic research is being urged on much more pragmatic grounds. Only recently Dr. Wernher von Braun, the Army's missile expert, declared:

"For years we have been talking too much about hardware, and too little about filling the vat of knowledge. We have been taking from that vat for years and putting little or nothing back in. Now we are scraping the bottom."

Dr. von Braun went even further and declared:

"I think a breakthrough by us is highly unlikely because our research programs are so terribly underfed.

"A breakthrough by the Russians, putting them even farther ahead, is much more probable."

Dr. von Braun proposed that a 10 percent "surcharge" be added to all missile development contracts, to be devoted to research "to advance the art."

A similar view was recently advanced from quite a different source. J. A. Livingston,[8] business columnist for the Washington Post and Times Herald, referred to a recent address by Stahrl Edmunds, former staff economist at the Ford Motor Co., who spoke on the poverty of basic ideas currently afflicting American business:

"Today," says Edmunds, "we have no backlog of ideas to draw upon—no readymade product for readymade wants. More-of-the-same mentality will lay an egg and it won't be golden. We have enough plant capacity to satisfy demand for the goods that go into the present standard of living. We require new products to launch a new long-term business cycle for the 1960's, just as the great missile and rocket advances were needed to launch the military into the space age."

[8] Washington Post and Times Herald, Jan. 23, 1959.

The advocates of greater support for basic research must inevitably face the question: "What good is it?" It is always possible to answer this question retrospectively because the history of applied science and technology is essentially the story of basic discoveries that were put to useful purposes. It is less easy at the time, however, because it is not possible to look ahead and predict exactly what applications may derive from the solution of the basic problems at hand. Sometimes, however, it is possible to make an educated guess regarding the potentialities of a new discovery. The story of helium is a case in point.

Helium was first discovered as an element in the solar spectrum by Sir Norman Lockyer in 1868. It was not known on the earth until 1894, when it was discovered by Sir William Ramsay among the gases he obtained by heating cleveite. Great difficulty was experienced in liquefying this new gas, but a Hollander, Kamerlingh Onnes, finally succeeded in liquefying it at about 4° above absolute zero. For this achievement he received the Nobel price in physics in 1913. Onnes' work in the liquefaction of gases became the basis of the famous Leiden cryogenic laboratory, a laboratory devoted to the study of the physical properties of bodies at very low temperatures. These studies revealed, among other things, that at very low temperature, a form of liquid helium takes on qualities of superconductivity, i.e., it has no resistance to the passage of electricity. If it were possible to make a superconductive power transmission line, costs could be materially decreased. Also, liquid helium is a better conductor of heat than copper and silver, our best conductors to date. In addition to its quality of superconductivity, liquid helium is a perfect liquid—that is, it flows with no friction. These phenomena are not as yet understood.

To date, helium has been found to have a number of uses: The compressed gas is used in guided missiles to force out the highly inflammable liquids or gases; to replace hydrogen in balloons; in welding, to shield the work from oxidation by the air or actual burning in case of inflammable metals like magnesium; it is also inhaled by divers and aviators to replace nitrogen in their blood, thus preventing the painful and dangerous disease known as the "bends." However, these uses are relatively minor compared to the potentialities that could be realized if we were able to master the phenomena associated with the behavior of helium at very low temperatures.

Helium is found only in the United States and recently in the U.S.S.R. It is found in oil wells and is associated with the presence of natural gas. At the present time in the United States, the Federal Government is the only agency collecting and preserving helium, and only doing so in a limited way. In most wells it is simply dissipating into the atmosphere and at the present rate it is estimated that it will all be gone by 1985. Clearly, helium represents a very basic and unique resource, with significant potentialities for practical application, once its phenomena are fully understood. We cannot say with assurance now when or how we may learn to capitalize on the remarkable properties of this element, but certainly they are worth our study and further research.

To return to the question of the desirable level of support for basic research, I should like to point out that of the $10 billion, which we estimate is currently being expended for research and development in this country, only a small fraction—something slightly more than 6 percent—is being expended for basic research. All the rest represents applied research, development, and test engineering, whose costs are much higher.

Actually, a more generous measure of support for basic research would ultimately reduce developmental costs by disclosing the ideas and avenues of approach that could be most profitably explored. Furthermore, wise expenditures for basic research can be used to reduce economic loss. Let me give you a couple of examples in the field of meteorology. The petroleum industry indicates that $100 million annually would be saved if the accuracy of seasonal forecasting could be improved by 10 percent.[4] The Standard Oil Co. of New Jersey employs on its staff a statistician, Mr. C. A. Wright, who analyzes Weather Bureau data from 55 cities for the last 50 years. Mr. Wright points out that:

"If we should underestimate the demand for furnace oil, our refining affiliates would have to resort to uneconomical production schedules or emergency trans-

[4] L. V. Berkner, "National Science Policy for the Space Age," University of Buffalo, Oct. 9, 1958.

portation to keep customers supplied. On the other hand, if we overestimate customers' needs, storage becomes a headache."

It is further pointed out that "A deviation of just 1 degree-day can swing demand up or down by 93,000 barrels. An increase of 1 degree-day for each day in the heating season would boost east coast demand by some 18 million barrels.[5]

Recently, Mr. Thomas Malone, meteorologist and director of research of the Travelers Insurance Co., pointed out in an address at the National Science Foundation, that something like $700 million is paid out by insurance companies as a result of storm damage in the United States in a single year. At the same time, Mr. Malone indicated, the United States is expending less than 10 cents per gainfully employed worker on basic research in meteorology.

Dr. Edward A. Ackerman, deputy executive officer of the Carnegie Institution of Washington, suggests[6] that we could afford 10 or 25 times that amount for fundamental research on the atmosphere. Dr. Ackerman's remarks were made at a recent symposium on weather modification, where all three of the panel members were in agreement that advances in weather modification are wholly dependent upon the acquisition of fundamental knowledge on meteorological processes that we do not now have.

In making a strong plea for support of basic research, I am, of course, directly concerned with the research that is carried on in our colleges and universities. At the same time, I feel that industry, too, has a definite responsibility in this area and could do a great deal more along these lines. The Federal Government is providing support for research in academic institutions, and we should like to see industry increase the support it is giving such research. Additional tax or other incentives might be considered as a means of increasing industrial support of basic research in the universities. At the same time, we should like to see industry expand the basic research efforts of its own laboratories.

I have already indicated that our NSF studies show that those industries with the highest level of research activity are also among the industries showing the greatest margin of profit. Dr. Guy Suits, vice president for research of General Electric has said[7] "If you do not expect to be in business 5 years from now, there is no need for expenditures for basic research * * *." Since industry is the largest consumer of the fundamental ideas uncovered by basic research, it should be willing to make it own contribution to the storehouse of new knowledge. Industry enjoys a number of advantages which should serve to stimulate its basic research activities:

(1) Industry employs the largest number of scientific personnel. Nearly three-quarters of a million scientists and engineers were employed by American industry as of January 1957. This total included 528,000 engineers, 152,000 scientists, and 58,000 administrators of scientific and engineering activities. Almost one-third of these scientists and engineers were engaged in research and development activities. The 738,000 scientists and engineers employed in the industries covered by a recent NSF survey are estimated to represent approximately two-thirds of all scientists and engineers in the Nation.

(2) In general, industry can afford the most modern laboratories and the largest and most expensive equipment. Some portion of these facilities should be devoted to basic research.

(3) Industry is able to pay the largest salaries for scientists, engineers, and technical personnel, and hence is always able to attract competent people.

Industries that now support basic research realize that its importance lies, not in the individual projects supported, but rather in the whole complex of research activity. The Du Pont Co., for example, reports that on the average only 1 in 20 of its research projects has proved successful. (Which one, of course, cannot be predicted in advance.) Yet the basic research program of the Du Pont Co. is one of the major reasons for its outstanding success. Then, too, industrial companies are coming more and more to recognize that in order to maintain progressive and successful research programs, they are obliged to provide basic research in order to attract truly creative people. People with genuine capacity for innovation and original thinking are usually not satisfied to spend their time working on the applications of other men's ideas.

In closing, I should like to cite one further aspect of research and development that is closely identified with the operations of our economy and that is

[5] "Prophet Mixes Oil and Weather," New York Times, Nov. 4, 1958.

[6] "Weather Modification," Science Resources, and Society Resources for the Future Forum, 1959.

[7] "Proceedings of a Conference on Research and Development" (NSF–58–36), National Science Foundation, Washington, D.C., 1958.

the competitive aspect. Competition, at the very heart of our free enterprise system, is also an important element in the research laboratory. It is paradoxical but true that science is advanced by competition and cooperation of research scientists.

Industrial companies today are competing on the basis of new products and innovations that come out of their research laboratories. As an executive of one large corporation remarked recently, "My company is competing with other companies not for current markets but for future markets."

Research and development may well be a decisive factor in determining whether small businesses are able to survive. With this in mind, the Foundation last year lent what assistance it could to Members of Congress in the preparation of the legislation which became the Small Business Act of 1958. Section 9(a) of that act declares that:

"Research and development are major factors in the growth and progress of industry and the national economy. The expense of carrying on research and development programs is beyond the means of many small business concerns, and such concerns are handicapped in obtaining the benefits of research and development programs conducted at Government expense. These small business concerns are thereby placed at a competitive disadvantage. This weakens the competitive free enterprise system and prevents the orderly development of the national economy. It is the policy of the Congress that assistance be given to small business concerns to enable them to undertake and to obtain the benefits of research and development in order to maintain and strengthen the competitive free enterprise system and the national economy."

What is true of research competition in business is also true of nations. We have already had evidence, as well as flat statements of the fact that the Soviet Union considers itself in an all-out scientific and technological race with the United States. Premier Khrushchev's remarks at the opening of the Soviet Communist Party Congress last week, together with the proposed new 7-year plan and other public statements, suggest that the Russians consider themselves in an economic race as well. Actually, economic progress is too closely tied in with the research and development effort to be considered separately.

Some of the news analysts are already viewing with alarm the gap between the 8 percent annual rate of Russian economic growth over the next 7 years, as predicted by Mr. Khrushchev, and our own annual rate which American experts seem to feel is somewhere around 2 or 3 percent.

What they appear to overlook is that we are starting from two entirely different bases. The Soviet Union is determinedly striving to achieve the standards of living which we in the United States have been enjoying for years. As the New York Times[8] commented editorially:

"The economic competition Premier Khrushchev speaks about so often is one we have always welcomed if what is meant is competition in giving people decent standards of living. On that basis it is simple truth to note that we still have a long lead. Even making the questionable assumption that Khrushchev's latest plans are all fulfilled on schedule it will be a long time before the Soviet people are as well fed, well clothed, and as well housed as is the average American today."

The real point is that we are competing with the Soviet Union for the future. As I said in the beginning, the economic implications of research and development are of a long-range nature. What we do now in planning our research and development effort, in giving it adequate support, may determine not only our own future but the future of the world as well.

Representative REUSS. Thank you very much, Mr. Waterman.

Before we go to the members of the committee, does any member of the panel wish to address question to his colleagues?

If not, at the moment, I will call on Representative Kilburn.

Representative KILBURN. Mr. Chairman, at the request of Mr. Curtis, I ask unanimous consent that this column from the Washington Post of February 1, 1959, be incorporated into the record.

Representative REUSS. Without objection, it is so ordered.

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[8] The New York Times, Jan. 29, 1959, p. 26.

(The document referred to follows:)

[Washington Post and Times Herald, Feb. 1, 1959]

BUSINESS OUTLOOK: FIGURES MISLEADING IN PRODUCTION RACE

By J. A. Livingston

America is in danger of idolizing growth for growth's sake.

Congressmen, economists, commentators, and writers have become fascinated by Soviet expansion. America, once the industrial hare, has become the economic tortoise. Russia, formerly the tortoise, has become the purposeful hare.

During the last 10 years, indexes of Soviet production indicate an annual rate of growth of 14 percent. In contrast, America has plodded along at the traditional 2.5 percent. Hence the phobia: The Soviet Union is rapidly overtaking us. Khrushchev will make good his boast and bury us, not with arms but with an avalanche of output. The bare data, uninterpreted, are scary:

*Annual percentage increase in production*

| Year | U.S.S.R. | U.S. | Year | U.S.S.R. | U.S. |
|---|---|---|---|---|---|
| 1949 | 22 | −8 | 1954 | 13 | −7 |
| 1950 | 25 | 17 | 1955 | 12 | 12 |
| 1951 | 16 | 7 | 1956 | 11 | 3 |
| 1952 | 11 | 3 | 1957 | 10 | 0 |
| 1953 | 12 | 8 | 1958 | 10 | −7 |

But wait. The statistics are stacked in Russia's favor. The Soviet data include primarily electric power, crude oil, steel, cement, and similar command resources. These are the products the Soviet Union needs to grow on. They are the components of military power. They are produced according to plan.

While visiting an automobile factory in Detroit, Deputy Premier Anastas I. Mikoyan pointed to a fin on a car and asked, "What's that for?" He was told, "Styling to sell cars." He put his hands to his head, smiled. That wouldn't do in the U.S.S.R. Too frivolous.

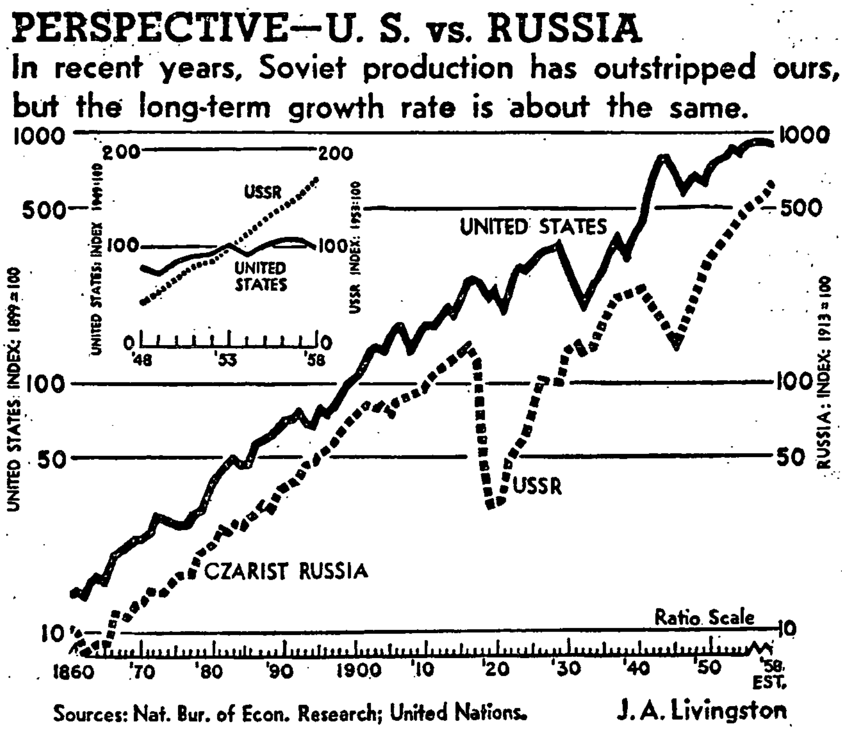
In the United States, consumption is the end of production. In the Soviet Union, growth is the object of production. Consumer goods are fuel to stoke workers.

Growth is muted statistically in the United States. Some of the most rapidly growing new industries—electronics, for instance—are not fully registered in the index. Coal shows a decline in trend, also soap. We use oil and gas instead of coal, detergents instead of soap. Such declines here are indications of technological change, but they embellish the pro-Soviet comparisons.

LONG-TERM PERSPECTIVE

A study by Prof. G. Warren Nutter, of the University of Virginia, for the National Bureau of Economic Research, indicates that the long-run industrial growth rate in Russia has been about the same as that of the United States. From 1860 to 1913, the annual growth rate of Czarist Russia was 5.3 percent as compared with 5.2 for the United States. From 1913 to 1955, the growth rate in Russia ranged from 3.3 percent to 4.7 percent a year; in the United States, 3.8 percent (see chart).

Only in postwar years has there been a decisive difference—about 14 percent versus 2.5 percent. This is explained partly by the difference in statistics, partly by the Soviet emphasis on industrial industries—steel, electric power, petroleum, cement—partly by the accelerated recovery in Soviet production from the wartime low, and partly by the greater breadth of the United States economy.




UNITED STATES STILL PRODUCTION CHAMP

Last year, the United States, with a population of 170 million, produced three times as much petroleum, electric energy, and meat as the Soviet Union with a population of more than 200 million. We produced 40 percent more cement; 30 percent more steel. And it was a recession year.

What is disturbing about the Soviet production is not the growth but the use to which the production is put—the intent of it. If the Soviet Union made more automobiles, the steel, cast iron, copper, and motors going into these extra autos would be diverted from the producers' goods, from growth. The gasoline needed to fuel those cars would be taken away from producers' goods.

If ever Khrushchev set his mind to improving the standards of living as he is now improving the methods of waging war, if ever the Soviet Union began making pliofilm to wrap food, autos to carry passengers, refrigerators and washing machines to improve living, the rate of growth would flatten out, and our rate of equanimity would improve. In absolute amount of output, Soviet Russia is still far behind, and will be for years to come.

Our danger is not that Khrushchev will bury us under an avalanche of output, but that we'll lose ourselves on a false, idolatrous quest of growth for growth's sake. Our problem is to produce what we need to survive and progress—not to engage in a battle of percentage comparisons.

Representative KILBURN. Mr. Waterman, is the National Science Foundation in the building where Rhode Island Avenue and Massachusetts Avenue meet near Scott Circle?

Mr. WATERMAN. We are now in the old Atomic Energy Commission Building on Constitution Avenue.

Representative KILBURN. What is that science building near Scott Circle?

Mr. WATERMAN. That is the American Association for the Advancement of Science. That is the scientific organization to which all the scientific associations in the country belong.

Representative KILBURN. Who supports the National Science Foundation?

Mr. WATERMAN. This is an independent Government agency. We get our funds from Congress.

Representative KILBURN. I would like to ask a question of Mr. Heymann, of the Rand Corp.

When you compare the rate of growth of the Soviet against ours, I presume you take into account the fact that, of course, if our growth has been much greater in the past and we started at 75 percent and they started at 10 percent, their rate of growth would be greater now. Would you comment on that?

Mr. HEYMANN. Yes, sir. It certainly is true that at one time when the Soviet economy was a relatively primitive machine it was relatively easy to achieve rapid growth over very small absolute quantities, but I am afraid, as of now, the Soviet economy is reaching a level of output where one can no longer attribute the rapid rates of increase to the primitive nature of the economy. It is now essentially in the small ball park, as our own.

Representative KILBURN. I have a question here, Mr. Chairman, that Mr. Curtis left with me, if I may ask it.

He said:

> I would like to have the panel discuss the significance and growth rates of the Western European countries from 1953 to 1958 in relation to the growth rate of the United States for this same period.

He makes a note here:

> This period is after the war construction period and most of the impact of the Marshall plan.

He would like to have the staff cross-reference this with the hearings on the first day.

(See p. 25.)

Representative REUSS. Would you yield at that point?

Representative KILBURN. Yes, sir.

Representative REUSS. I think the panel may not have seen the chart, introduced the other day, to which Mr. Curtis refers. As I recall, that chart showed a growth rate among the Western European countries of nearly 5 percent per year, in the 4 years from 1953 to 1957.

The average rate of growth in real gross national product from 1953 to 1957 for OEEC member countries was 4.7 percent, while the United States growth rate during that period was 2.5 percent.

Representative KILBURN. They cannot very well discuss it unless they understand the reference.

Representative REUSS. We would appreciate your comments on the difference in the growth rate between Western Europe and the United States.

Mr. EISNER. One comment I might offer is that the picture may not be the same if you carry it through to 1958 and to 1959. As I understand it, there has been a general slackening of economic activity in Western Europe.

Mr. HAMBERG. I think if you went back before 1953 you would find maybe the opposite is true. Those figures might be reversed in relationship if not absolute magnitude.

Representative REUSS. Let me give you some of the other figures on the chart, Mr. Hamberg. During the period 1948 to 1957, OEEC annual rates of growth were 5.2 percent. Our own were 3.7 percent.

Mr. HAMBERG. What period was that?

Representative REUSS. 1948 to 1957. If you take the period 1950 to 1953, when the Marshall plan was still going strong, OEEC's growth rate was 4.2 percent and our own was 5.1 percent.

Incidentally, that is the only period or segment of a period in the last 10 years where our growth rate was in excess of the rate in Europe.

Mr. HAMBERG. I had a figure here on output per man-hour between 1947 and 1953 at the rate of 3.7 percent. Probably if you added some growth rate in labor supply it would come out close to 5 percent.

Representative REUSS. The significant thing to me of these figures, and I happen to have a member of the Joint Economic Committee mission to Western Europe last fall which dredged them out, was that they show us not looking so good. The Western European countries, at whose economic performance we have been disposed to look down the side of our nose, seem to be doing twice as good as we.

Mr. HAMBERG. In that period we had two recessions which virtually left the European countries unaffected. That is an explanation, not a justification. I wonder if some of the explanation would not also be explainable by, say, a similar sense of dedication in those economies as opposed to ours, the program for recovery and modernization, and so on, as opposed to our economy where we were content with more tail fins.

Representative REUSS. Mr. Fisher?

Mr. FISHER. I would make three comments on the question.

One is, though I do not have the figures right here obviously, it quite well may be that the Western European economies in 1948 began from a much lower level, not having yet worked their way out of the wartime dislocations. That would mean that their average annual rate of increase over the 10 years could be much higher for this reason.

The second point is that, largely because of the previous war, these countries may well have been devoting a much higher proportion of their total productive effort to investment and growth industries than we.

The final point is that it makes a great deal of difference which particular period of years you choose for comparison. Many economists make quite a game out of arguing this back and forth, each one choosing a different set of years. For example, taking the U.S. gross national product in 5-year periods since 1930, you get average annual growth rates during 5-year periods ranging from minus 1.5 to plus 8.8. From 1945 to 1950 you get a 0.3 percent rate of increase. From 1950 to 1955 you get a 4.3-percent rate. Much depends, therefore, on which particular set of years you choose.

Representative KILBURN. May I ask a question there?

Representative REUSS. Yes.

Representative KILBURN. I was with Mr. Reuss on his trip and the thing that impressed me over there in those countries, and I think it impressed Mr. Reuss too, is the absolute necessity for them to develop competitive goods in the world market because they live on imports whereas we do not.

Do you think that that factor enters into these rates?

Representative REUSS. Mr. Striner.

Mr. STRINER. May I ignore that question for a moment, sir, and pursue something else which really deals with this?

I think that for some years now we have been committing a serious error in our thinking. We tend to compare ourselves always with other countries, other rates of growth.

Aside from the question of the fact that often the definitional base, the years which are chosen for comparison purposes are such that we really cannot make a valid comparison, I wonder if we get very far by comparing ours with someone else's?

This is an interesting case of invidious comparison, of keeping up with the Joneses. What if the Joneses should not do so well? Does that indicate to us that perhaps we can relax?

I think what is most important for us at this time is not continually to look at the Soviet economy and if they are growing at the rate of 8 percent or 9 percent, or if they only grow at the rate of 2 percent, allow it to influence our national defense policies.

I think it is time for us to determine sensibly what our objectives are, what our responsibilities are, what our resources are, how we can best use our resources, what sort of sacrifices might be entailed in terms of our responsibilities, and then indicate to ourselves and others what course of action we are going to follow.

It is somewhat unsophisticated and naive for us to continually look to our neighbors to discover at what rate of growth they are proceeding. Should we beat them out? "Of course we should" is usually the answer, although we are not so sure why or in what way.

I do not want to throw cold water on this comparison of growth rates, but I think we are approaching this question of national economic development and growth from the wrong end.

Representative REUSS. Mr. Bolling?

Representative BOLLING. I think that last comment is a very interesting one and I think unquestionably an accurate one. I think you will find that most of the people in American politics who are emphasizing problems of growth are doing it primarily as a method of demonstrating that in their view American policy is not meeting the kind of criteria that you propose, that we are not making the right national decisions as to how to use our resources, and so on.

There seems to be a consensus that as far as policy is concerned, one can take at least two approaches.

One is to have an increased rate of growth in this country so that there will be, in oversimplified terms, a larger pie from which to serve various policies, foreign and domestic, or one can say we will keep reasonably complacent about the rate of growth that we do have and make it perhaps on a subjective basis a series of decisions as to how the smaller pie will be cut up.

This is not in technical terms but I gather that there would not be much disagreement with this general view.

Just for the moment, assuming that a political economist as opposed to an economist were viewing it and came to the conclusion that it would be much easier to deal with the problems of selection as between this good and that good and the private desire and the public good out of a larger pie, then comes the question, Is there a general agreement that Federal policies can affect rate of growth of the economy of the United States? Is there any disagreement with this? Everybody agrees that Federal policy as a package of policies can affect growth. Does everybody agree further that at least two things are growth producing, research and development?

Is there any disagreement that research and development, on the long run, is growth producing? Is there any disagreement that education on a more general basis is growth producing?

Mr. HAMBERG. What?

Representative BOLLING. Education on a general basis both quantity and quality is growth-producing? Is this generally agreed?

Now, what other Federal policies, for example, do have an effect on growth?

Those two are generally accepted apparently.

What kind of tax policies should the Federal Government have to increase growth? Would anybody comment on that? I will not venture to try to get a consensus of this panel on that subject.

What kind of tax policies? Can tax policy affect growth? Everybody agrees with that. What kind of tax policy should there be to increase growth?

Mr. EISNER. I would emphasize that the important thing about tax policy insofar as it affects growth is very clear cut. It is that the tax policy be geared to the objective of full or maximum employment because, to the extent we have less than full employment, we simply dissipate resources and dissipate them largely in the area of accumulation of capital equipment and plant which is critical in growth.

I might add just one qualification on the suggestion that research and development contributes to growth. I think it certainly does. One always has to have the qualifications, other things being equal. If the expenditure by corporations of billions of dollars for research and development has the effect of drawing away from universities, from nonprofit institutions, rather scarce basis skills of scientists and scholars and social scientists, and if Government does nothing about this, we may actually find that we would have been better off if we had not had the corporations spending so much on their own applied research and development.

Representative BOLLING. This would be the division between the applied and "pure" science?

Mr. EISNER. Yes.

Representative BOLLING. Are there further comments?

Mr. WATERMAN. May I speak to that, sir?

Representative BOLLING. Certainly.

Mr. WATERMAN. That raises the question of whether or not Government ought to consider any ways and means it can to provide funds by amending the taxation laws to make it more possible for universities to receive contributions from industry or private individuals. If the Federal Government feels it should not support these things directly, then it seems to me it is also the duty of the Federal Government to look into whether it may make it more possible for private sources to be found.

Representative KILBURN. Would the gentleman yield?

Representative BOLLING. Certainly.

Representative KILBURN. Of course, the Government also has to take into consideration the very important thing of the stability of the dollar. Does anybody want to comment on that?

Mr. EISNER. I should be happy to comment on that in that I think that the stability of the dollar is a somewhat desirable objective but we may have to face very flatly the question of whether we are not willing to risk at least a slight increase in the price level if we find that our economy functions in such a way that with this slight increase in the price level we can actually have a much higher level of employment. The difficulty is that a lot of people that talk about the stability of the dollar have, as a set of policy recommendations those things which, while they may well preserve the stability of the dollar, very likely, on the basis of the best information economists can offer, also contribute to a substantial level of unemployment.

Back in the thirties there is no question that the dollar went beyond being stable and prices fell. There is no question that if we are willing to tolerate sufficient unemployment we will have a stable dollar.

This point, then, is that we must not sacrifice any utilization of our resources of which we are capable in order to keep the dollar stable and unless people can come out with very well thought out programs for tax policies that would keep the dollar stable and give us full employment, I think it would be courageous and honest and in the interest of the people as a whole to recognize that perhaps we should have some price inflation and full employment and then see to it that the Government takes the necessary measures to help those people such as, for example, the elderly on social security benefits, to get some relief from the hardships that the moderate price inflation might cause.

Representative BOLLING. What about monetary policy and its effect on growth? Does anybody wish to comment on that? What can monetary policy do to achieve a greater rate of growth?

Mr. HAMBERG. I will try to make some brief remarks on the point. I, frankly, think that by way of stimulating growth there is probably very little it can do.

Representative BOLLING. The famous pushing on the end of a string.

Mr. HAMBERG. In a sense. I think, for example, by assuring adequate growth in the money supply under growth conditions it can create the permissive elements for growth; but by itself I doubt that it can add very much by stimulating growth and on the contrary I would probably feel that as far as monetary policy tends to be anti-inflationary, many of its effects tend to be inimical to growth.

Monetary policy by itself, as has been pointed out, I believe by earlier colleagues appearing before this committee, can be very discriminatory.

Let me cite just one case in point. Obviously, it is most discriminatory against small borrowers, small firms. I believe that small firms still have a lot to contribute in the competitive economy. I am addressing myself here to the growth question. Small firms still can contribute much by way of research and innovation.

I think there are a number of arguments that you can make contrary to the usual ones that the small firm is apt to be a more willing innovator because it has less vested interest, less to lose, and so on, than a large firm, and the question becomes whether it has the capacity to innovate.

Insofar as a tight money policy impinges on the borrowing capacities of small firms, to this extent it reduces their potential in the innovation field. Moreover, insofar as a tight money policy reduces many forms of investment spending generally it tends to retard growth.

Representative BOLLING. Mr. Fisher, did you have a comment?

Mr. FISHER. Yes. You have asked about the effect of tax policy and monetary policy on economic growth. I think this is causing most of us to have to shift gears. Our comments thus far have been set in a much longer perspective than current debate over tax and monetary policy usually is set. I find it helpful to separate the long and the short run here.

Over the longer period, that is longer than a business cycle, I think Mr. Eisner's point is the commanding one, that the policies in the tax and monetary field should be gaged according to their effect upon maintaining a very prosperous economy.

I myself would take this to mean a rather prompt and vigorous anticyclical use of both these types of policy on both the up and the down side of the cycle.

Looking beyond that to the longer run, I think a variety of things come to mind, and of a more specific nature. One Dr. Waterman has mentioned, to alter tax regulations in such a way as to promote the channeling of more funds into places where they are more likely to be used for basic research.

One might say also that the tax policies which firmly, but still in not too dictatorial a fashion, direct a bigger cut of the total pie, to use your term, into investment and particularly investment in the basic growth producting industries wold be a good thing.

Representative BOLLING. Thank you.

Now, I would like to shift very quickly, if I still may go ahead.

Representative KILBURN. Before you shift, would you yield for a moment?

Representative BOLLING. Surely.

Representative KILBURN. I have been here for 19 years, and I am very fed up with the recurrent idea that the Federal Government can always put more money in a proposition because it sounds good and is appealing, forgetting, what in my judgment at least, is the basic thing. We have to keep our dollar sound to make any progress at all in this country in employment and everything else. It is always easy to say, "Let's have a little tiny bit of inflation. That won't hurt anything, a little price increase." That has been going on year after year.

I would think that you men here would think it might be wise to stop, look, and listen for a minute and maybe not go quite so fast in order to keep our economy sound.

Mr. HAMBERG. May I direct a specific answer to Representative Kilburn's question?

Mr. Kilburn, leaving aside the issue of whether a little inflation is bad or not, it seems to me that there is nothing inherently contradictory between statements such as those made by Mr. Fisher and Mr. Waterman about the Federal direction of resources into what we might deem more desirable channels and the problem of price stability.

We do have a tax tool at our hands and the tax tool can be viewed as a way of rechanneling resources, let us say, into some desirable directions without sacrificing price stability if that is the desideratum. This seems to me, in other words, more basically a question of coming back to this issue that somehow Federal spending is to be held as inherently bad and private spending is inherently good; really the issues being raised here today are questioning that view and implying that perhaps there is something wrong with certain areas of private spending.

Certainly this seems to me the tenor of the times and of remarks by people who are troubled by our growth rates and our wastage, if you like, of resources. This is what they are talking about and it seems to me that taxes and tax revenues give us the means of getting something else than what we may have and something that we may consider more desirable by diverting resources from one channel to another without increasing total spending, or at least permit total spending to grow faster, let us say, than output, and creating inflationary pressures.

It seems perfectly conceivable to me that price stability and reallocation of resources are perfectly consistent objectives.

Representative REUSS. Mr. Bolling?

Representative BOLLING. I believe Mr. Striner has something to say.

Mr. STRINER. In answer to Mr. Kilburn, I think most things in this life involve costs and benefits. We have value judgments as to what we would like to have.

You use the term "sound economy." If we have, as our criterion, full employment, that is everyone with a job and everyone able to obtain sufficient funds to take care of the requirements of his family, there may be some costs involved. There are always costs. Inflation may be one of them.

The point, I believe, is not really one of inflation but how much inflation are we able to put up with? No one I know likes inflation per se, but most of us like a job, also.

The real question is, given certain State and local policies to maintain high levels of employment, how much of the inconvenience of inflation and how much of the inconvenience of not being able to get certain goods when they are relatively scarce are we willing to put up?

In order to have defense, how much inconvenience are we willing to put up with as employers in order to get certain skills which are being bid away from us?

Historically prices have always been changing. In the present area bill which Mr. Douglas is submitting—and I wish he were here now, there is a statement in which it is indicated that in helping any depressed area you are not supposed to curtail the economic activity of any other area. That is very difficult to do because, if you are going to succeed in boosting one area and increasing its competitive ability vis-a-vis other areas, of course you are affecting other areas. Is the effect on these latter areas going to be of such a marginal nature that it is limited and yet the benefited areas will improve their economies tremendously? This is what is of importance, I presume.

Representative BOLLING. I asked the members of the staff to give each of you a copy of the Economic Report open to page 67. It is title II that I would like to draw your attention to. It is headed, "Measures To Promote Economic Growth With Price Stability."

I will give you a moment to glance over those quickly and then I would like to have an answer from each member of the panel as to whether in their opinion these particular measures will promote any substantial amount of economic growth.

Is there any feeling on the part of any member of the panel that these measures will stimulate vigorous economic growth?

Mr. FISHER. It would be my opinion that each of these measures, certainly most of them, would be helpful but that each one is a rather tiny bit and, even if you add them all up, nothing very massive results.

Representative BOLLING. Would there be any disagreement on that point? Mr. Eisner?

Mr. EISNER. I would agree that none of them is going to give very much help. But in line with my earlier remarks, I would add that "to amend the Employment Act of 1946 to make price stability an explicit goal of Federal economic policy" would have every likelihood of diminishing the economic growth. If it were to be taken seriously it would mean, for example, that in the recent recession even the limited measures that the administration took to counteract unemployment would have been measures that it should not have taken because, allowing that budget deficit to develop as it did in the past fiscal year, is something that they should certainly have avoided. They should have raised tax rates if they had wanted to keep the dollar stable and keep prices from going up.

I think that to throw this kind of amendment in is to hopelessly confound the problem.

Representative BOLLING. Your judgment is that the small pluses and fairly large minuses come out pretty near even?

Mr. EISNER. I would want to examine each of the individual pluses more carefully.

Representative BOLLING. Does any member of the panel disagree with the more gentle position taken by Mr. Fisher?

Mr. WATERMAN. I just want the record to note the fact that these matters are beyond my field of competence except the item on helium, and I did comment on that.

Mr. BARRETT. I want to say the same.

Mr. HEYMANN. I am in the same position since my expertise is the Soviet economy, but I cannot help but compare the lack of audaciousness which appears to be here with what appears in Khrushchev's 7-year plan.

If I may say a few words about that, Mr. Striner has taken me to task by pointing out that it is foolish to look at the Soviet economy when what we should be worrying about is the U.S. economy, but it does seem to me rather striking that the Soviet economy has made its choice on the side of rapid growth and also faces some sort of a dilemma with respect to stability. There is no question but that the Soviet economy is chronically overcommitted in its resource allocation and suffers, if anything, from overfull employment rather than underemployment of resources. The resulting pressures on the Soviet monetary system and the repressed inflationary conditions which result can be taken care of very nicely in the Soviet economy because of the centralized regulation by the regime, but there is still a conflict even there and it is interesting that Khrushchev has certainly made his choice unequivocally on the side of growth.

Representative REUSS. I will get to you in just a moment, Mr. Striner. There is a question which I want to ask both you and Mr. Heymann.

Mr. Heymann states that the Soviet growth rate was about five times that of the United States in the last 8 years—that it averaged about 10 percent as contrasted with our growth rate of 2 percent. You gave as a reason for the tremendous Soviet growth rate, the regime's centralized direction and authoritarian control of its resources. I am quite sure, it would be generally agreed by the members of the panel, as it would be by the members of this committee, that this country would not be willing to buy a 10 percent growth rate at the price of a Soviet-type authoritarian control.

My question, however, is this: Granted that we do not want a Soviet-type authoritarian control over our resources, what growth rate do you think is consistent with our national objectives and attainable under free and democratic economic procedures.

Would both you and Mr. Striner respond to this question?

Mr. HEYMANN. Before I answer this very difficult question, may I correct the record slightly? You said I indicated a Soviet growth rate five times as large as ours. This was with reference to a very specific measure, namely, industrial materials, during a critical period, 1950–57, where we happen to have done very badly. Nevertheless the comparison of a superior growth rate for Soviet industry still stands.

Representative REUSS. But it is a comparison of relative performance during the last 8 years.

Mr. HEYMANN. Right.

On your question, I do not really believe that I could engage in the sort of crystal-ball gazing of saying specifically what rate of growth would be consistent with our institutions.

I would merely say this: that the Soviet economy is willing to accept, maybe the individual does not have any free will in this, but the economy is certainly willing to accept a rate of taxation and a rate of sacrifice of consumption that gives us pause. The Soviet citizen is forced to accept this.

We, at this point, have not faced up, I believe, to the need to accept perhaps certain sacrifices in our own consumption in order to meet the challenges which face us which are challenges of our own and not merely posed for us by the Soviet Union.

Representative REUSS. You talk about challenges and sacrifices in our own consumption at a time when we have over 4 million unemployed and, according to the President's report, are using only three-quarters of our industrial resources. You imply a choice between tail fins and other things, which I would not think is yet forced upon us.

Mr. HEYMANN. It may not be. It may be that there is a thorough consistency between a higher rate of taxation in the United States and a higher standard of living. It is not at all a foregone conclusion that these two are mutually exclusive.

The only point I make is that the Soviet Union is making sacrifices, whether voluntarily or not. If sacrifices are needed in this country, it seems we may have to face up to them.

Representative REUSS. Mr. Eisner?

Mr. EISNER. I might add that if we are really talking about growth, the figure of 4 million unemployed tremendously underestimates the unutilized potential employment. It ignores the people who do not feel they can get jobs, do not turn up as technically "unemployed" because they do not think they can get jobs and hence are not in the labor force. In the Soviet Union there are millions and millions of women working and frequently working in very skilled capacities. The effect of unemployment is largely to make it difficult for people who are generally marginal in the labor force to get jobs at all.

If we stop to think of ways in which we can offer jobs to not only the 4 million actively looking for work but many millions more including very largely women who would be happy to work if there were jobs for them, I think we would find our potentialities for growth are greater than we have dreamed of.

This, by the way, is the explanation for the tremendous growth that we enjoyed during the war years.

Representative REUSS. Mr. Striner, do you have any comments on this?

Mr. STRINER. Let me say at the outset, since some of these things may get beyond this room and because of the relationship which ORO has with the Army, that nothing I am saying here should be taken to be necessarily the views of the operations research office of Johns Hopkins or the Army for whom we do most of our work.

Secondly, there is no controversy with Mr. Heymann. I was not attacking his position. What I was saying is that we should not look merely at the rate of growth of the Soviet economy or the rate of growth of any other economy and take that as a point of departure and say that if they are growing at a rate of 8 percent or 10 percent or 15 percent we also should be growing at that rate. I think I would say that, as a matter of fact, in the case of the Soviet economy perhaps we can see the sort of thing which perhaps we should be doing. They indicate, and their rate of growth is just a symptom, that they have clearly defined objectives in view and that they are ready to make sacrifices to attain those objectives.

Several years ago the President indicated that he was going to call for sacrifices from the citizens of this country; at the present time most of us are still waiting to see what these sacrifices are going to be.

In the defense budget hearings taking place now we seem to sense that there is an inadequacy someplace. Generals, admirals, secretaries of certain departments seem to be saying in veiled terms, "Perhaps we are not so happy. Perhaps we should spend more for missiles or aircraft or SAC bases or whatnot."

I have a feeling that the sacrifices which we thought we were going to be called upon for have not materialized. It may be that we need not make the sacrifices but I suspect we do.

I agree with Mr. Heymann that the Soviet system seems at least to have clearly defined objectives and a sense of the threats they see, real or imagined, and that they are doing something about it, although I am not advocating that we go to the Soviet system.

I would return to my earlier statement that everything in this life seems to entail costs and benefits and if we feel our objectives and responsibilities call for a greater level of output and greater allocation of resources for defense we have to be willing to make the funds available. We have perhaps to call on older people, on people who perhaps would rather stay at home, for these people to come into the economy and produce.

I think we are at the present time underutilizing our capacity. We find that people who could be producing are not producing, both the presently unemployed and the people Mr. Eisner referred to. I think that if we set our objectives properly we can undoubtedly attain higher rates of growth than we have up to the present time.

Representative REUSS. Let me ask this question:

As indicated by the chart on growth comparison referred to earlier this morning, the average rate of growth in gross national product in the United States from 1953 through 1957, the most recent years for which we had figures at the time of preparation of this table, was 2.5 percent.

The President's Economic Report, without stating at any point what ought to be a good target of national growth for the future, does, by its acceptance of recent performance, it seems to me, indicate a continued satisfaction with something on the order of an average of 2.5 percent.

Does anybody on the panel think that 2.5 percent is an adequate rate of growth of real gross national product for this country for the years to come, or do members of the panel think that a larger rate of growth is desirable?

Mr. FISHER. I do not think it is desirable or sufficient, given the state of affairs in the world.

I propose that for a target or goal a minimum of 4 percent should be stated, and 5 percent would not be too high. I would argue for setting it measurably above recent historical experience as a matter of target setting. I would argue further that the overall percentage is not as important as the makeup and components of that growth, and make a case for a variety of policies which would favor research and development and investment in the basic and growth-producing industries, and that this should be clearly stated as a matter of national policy and objective.

Judged against that, I find the recommendations which were drawn to our attention to be far, far from adequate. Indeed, they are more dominated by a concern with price stability than they are with economic growth and added up I do not think would produce any very great effects. I would have preferred myself to see mentioned under the heading "Measures To Promote Economic Growth With Price Stability," such straightforward and direct matters as education, research, and development, the conservation and development of basic resources. I think this would square more nearly with the kind of economic growth we in this country should aspire to than anything I have found in this report.

Representative REUSS. Does any member of the panel feel that a rate of growth on the order of as low as 2.5 percent is adequate for this country for the years to come?

I see no hands on that. I assume that you all believe a higher rate of growth is required by our national needs.

I have one final question. Does any member of the panel feel that the annual Economic Report of the President would be a more valuable document for the Congress and the Nation if it contained a statement of the goals of future economic growth?

Mr. HAMBERG. It seems to me that it has done that in a rather vague and haphazard sort of way in one report or another.

I have the feeling that the lack of inspiration in the present report is a reflection of the lack of inspiration in the administration. The Council of Economic Advisers are members of the administration. The administration is being very cautious, uninspired, with the problems of the present era and the report presumably was written under the impact of the administration's thinking, reflecting that completely.

There are earlier reports where they do talk about goals such as education and so on, very broadly and very generally.

I think it probably would be desirable if they got more specific and studies were made to determine needs and requirements instead of making these broad platitudinal remarks that everyone agrees, with just as everyone is against sin.

Representative REUSS. Mr. Heymann, did you have an opportunity to read the Livingston column from the February 1 issue of the Washington Post, which I think was put in the record by Mr. Kilburn?

Mr. HEYMANN. No; I am afraid I did not.

Representative REUSS. Since it relates to the matter of comparative Soviet and United States growth. I wonder whether you would read it and, if you care to do so, direct a letter with your comments to the Joint Economic Committee. We would like to make that a part of the record in connection with your testimony.

Mr. HEYMANN. I will be glad to do that.

(The following was subsequently received for the record:)

THE RAND CORP.,
*Washing, D.C., February 10, 1959.*

HON. PAUL H. DOUGLAS,
*Chairman, Joint Economic Committee,*
*U.S. Congress, Washington, D.C.*

DEAR SENATOR: In the course of my testimony to the joint committee on February 2, Representative Reuss invited me to comment on the J. A. Livingston column that appeared in the Washington Post of February 1, 1959. I have now had an opportunity to read the column and respectfully submit my comments, as follows:

The burden of Mr. Livingston's message is that we have no reason to be concerned about Soviet economic growth. In order to reassure us on this score, he presents three arguments, evidently designed to place the Soviet performance "in perspective."

(1) Soviet growth, he argues, is not balanced growth, but follows a special pattern that stresses the components of military power and largely ignores the consumer;

(2) Soviet growth, he finds, has outstripped ours only in recent years—the long-term rate of growth has been about the same as that of the United States;

(3) Soviet growth, he muses wistfully, would "flatten out" if Khrushchev would only allocate his resources as we do in the United States, i.e., predominantly to consumption.

I find these arguments singularly unpersuasive.

On the first point, I wonder what comfort Mr. Livingston derives from the fact that Soviet growth is not balanced growth. I would have argued that it is the more worrisome to us for the very fact of its imbalance; that it is dangerous to us precisely because it is not geared to the consumer, but dedicated overwhelmingly to the growth of those sectors of the economy that contribute most to the further expansion of Soviet military power.

On the second point, I take vehement exception to Mr. Livingston's attempt to foist off on his readers a highly misleading "long-term perspective" comparing Russian and United States output over the period 1860 to the present. Does Mr. Livingston really believes that the performance of the Czarist Russian economy from 1860 to 1913 is relevant to an understanding of contemporary Soviet reality? And is there any rhyme or reason to a long-term Soviet growth rate averaged out over a period as turbulent and abnormal as the years 1913–55, a period which, for the Soviet Union, included two disastrous world wars, a violent revolution, and a severe civil war? A glance at Mr. Livingston's graph and a quick recollection of the historic events that lie behind it should be sufficient to convince anyone of the futility of reading a meaningful long-term trend into such a period of history. In order to have some predictive value, our measurements of Soviet industrial growth must eliminate the abnormal years, both those of disastrous decline and those of rapid postdisaster recovery. One recent attempt to do just this resulted in an average annual growth rate of 9.7 percent for Soviet industrial output during 22 effective years of growth over the period 1928 to 1956. (*See* Gregory Grossman, "Thirty Years of Soviet Industrialization," Soviet Survey, October 1958.) This is a far cry from the 3.3–4.7 percent cited by Livingston, and it surely provides a more relevant perspective for gaging Soviet growth capabilities.

On his third argument, Mr. Livingston's judgment is no doubt sound when he conjectures that the Soviet rate of growth would flatten out if Khrushchev were to devote the bulk of his resources to consumers goods as he is now devoting them to producers goods and the implements of war. The fact of the matter is, however, that Khrushchev has not the slightest intention of even moderately shifting his pattern of resource allocation in that direction. This is clearly indicated in the investment statistics of the new 7-year plan. Over the next 7 years (1959 to 1965) the plan intends to maintain much the same investment allocation pattern as has prevailed over the last 7 years; in other words, there is to be no large-scale diversion of resources from growth-promoting and defense-promoting uses to agriculture, housing, or consumption. Nor is there any indication that the share of consumption in the Soviet gross national product is to increase. This is not to say that the consumer's lot will not improve under the new plan. It most assuredly will, particularly in the fields of housing and consumer durables. But the greater benefits that will accrue to the consumer will not derive from a diversion of resources away from the growth-inducing sectors, but it will result simply from the growth of total output. The consumer's slice of the pie will be bigger only because the pie itself is growing, not because the angle of the cut has been increased. In short, Mr. Livingston's conjecture is merely wishful thinking.

On one point I am in hearty agreement with Mr. Livingston; namely, when he tells us that "our problem is to produce what we need to survive and progress * * *." But the cost of survival and progress comes high in the age of total competition, and it will require an ever greater shift of our resources from private consumption to public consumption and national defense. In our economy such a steady and mounting diversion is not likely to be supported except in a context of rapid and sustained economic growth.

Yours sincerely,

HANS HEYMANN, JR.

NATIONAL SCIENCE FOUNDATION,
OFFICE OF THE DIRECTOR,
*Washington, D.C., February 6, 1959.*

The Honorable PAUL H. DOUGLAS,
*U.S. Senate, Washington, D.C.*

DEAR SENATOR DOUGLAS: With reference to the hearing I attended before your committee on February 2, 1959, it occurred to me that it might be helpful if I provided an answer, from the standpoint of present Government policy, to the question you raised with Mr. Barrett, the first witness at the hearing that morning. As I recall it, the question was whether an agency of the Federal Government, such as the Department of Defense, should or should not conduct or support basic research, or whether basic research support by the Government should be provided entirely by the National Science Foundation.

Present policy in the Government is expressed in Executive Order 10521 dated March 17, 1954, section 4, which is as follows:

"SEC. 4. As now or hereafter authorized or permitted by law, the Foundation shall be increasingly responsible for providing support by the Federal Government for general-purpose basic research through contracts and grants. The conduct and support by other Federal agencies of basic research in areas which are closely related to their missions is recognized as important and desirable, especially in response to current national needs, and shall continue."

I feel that this policy is entirely sound. In effect it states that such basic research may and should be performed or supported by Federal agencies as can be justified and defended in their budget. The mission of the National Science Foundation is the encouragement and support of progress in science by basic research, i.e., progress in the knowledge and understanding of the physical universe and of man. History shows that most of the outstanding scientific discoveries have come about through basic research. This in turn has of course always been stimulated by the need to solve practical problems and also by the practical inventions and applications from science which provides tools and techniques for further basic research.

Thus, the National Science Foundation has a comprehensive program of support in basic research throughout the fields of mathematics, the so-called physical sciences and engineering, the biological sciences, and also selected fundamental research in the social sciences where scientific criteria are satisfied as to aim and method.

In my opinion agencies with practical missions, such as the Departments of Defense and Health, Education, and Welfare, require the understanding of their technical problems which comes from active interest and participation in relevant basic research in order wisely to select and undertake applications of science and developments to accomplish their missions.

In the matter of performance of basic research in research and development laboratories under Government management, I believe it is important that scientists at such laboratories have opportunity to engage in basic research significant to the enterprise, again to provide a better understanding to the laboratory for the achievement of its aims and also to provide a means of communication and recognition between the laboratory scientists and those elsewhere who are working in the same fields of science.

I trust that this may be helpful to you in answer to the question you raised. If I can be of further assistance, please do not hesitate to let me know.

With best regards, I am,

Sincerely yours,

ALAN T. WATERMAN,
*Director.*

Representative REUSS. I want to thank all of you gentlemen on behalf of the Joint Economic Committee for your invaluable contribution.

The committee stands adjourned.

The hearing tomorrow will be held in this room at 10 o'clock.

The subject will be "The Structure of Business and the Employment Act of 1946."

(Whereupon, at 12:05 p.m., the committee was recessed to reconvene at 10:10 a.m. Tuesday, February 3, 1959.)

# JANUARY 1959 ECONOMIC REPORT OF THE PRESIDENT

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**TUESDAY, FEBRUARY 3, 1959**

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met at 10:10 a.m., pursuant to recess, in room 457, Senate Office Building, Hon. Henry S. Reuss, presiding.

Present: Senator O'Mahoney; Representatives Reuss and Kilburn.

Also Present: Roderick H. Riley, executive director; John W. Lehman, clerk.

Representative REUSS. The committee will be in order. The committee at the moment consists of Senator O'Mahoney, Representative Kilburn, and myself. Our chairman, Senator Douglas, regrets very much that he is not able to be here. He is on the floor in connection with the housing legislation.

The subject of today's panel discussion is "The Structure of Business and the Employment Act of 1946." I have telegrams from Mr. Carl Kaysen at Harvard and from Mr. Eugene Rostow at Yale expressing regrets that, owing to a change in their plans they are unable to be with us this morning.

The first participant in the panel discussion this morning is Mr. Solomon Barkin, director of research, Textile Workers Union of America.

Mr. Barkin.

## STATEMENT OF SOLOMON BARKIN, DIRECTOR OF RESEARCH, TEXTILE WORKERS UNION OF AMERICA

Mr. BARKIN. I am rather happy, Mr. Chairman, that the committee has introduced the problems relative to the structure of our economy and its adequacy in attaining both goals of stability and growth, for I have long felt that the discussions restricted to problems of monetary and credit policy, or direct competition, are hardly adequate to deal with these various problems. And I am, therefore, most happy that we have an opportunity of examining our economy and the President's Economic Report from this point of view.

My statement is as follows:

The President's Economic Report recognizes several structural defects in our economic organization. But a more far-reaching analysis and prescription are required if we are to attain the degree of stability and economic growth to which we, as a nation, aspire.

We would agree on its own merits with the general emphasis on the need for a stable price level. But we do not believe that there is any value in or necessity for adding an explicit directive to this effect. On the contrary, its insertion at the present time in the preamble of the Employment Act would tend to subordinate, as the present administration has already done, the objection of maximum employment to that of price stability, which emphasis we do not condone.

Furthermore, this stress on price stability also tends to minimize the objective of economic growth. While the Economic Report speaks confidently of our economy having achieved a significant victory over the recession, it is quite vague about the Nation's future growth pattern. It makes no affirmative declarations of goals. There is a complacency about the rate of growth which is ill suited to the tempo of our times.

The report is practically silent about the economic battle to which Khrushchev has challenged us. This is a type of cold war to which we should respond. We should bend our every effort to shape our economy to win and best the Soviet system in this competition. But the report is practically silent on this subject and fails to make any recommendations to the Congress on basic legislation necessary to improve our economic structure so that it may better outdistance the Red contenders.

I might make reference to the fact that this kind of conservatism which is exhibited by the present administration is not a constructive one; it is a stick-in-the-mud attitude which can hardly serve us in the present society.

Unfortunately, we can no longer smugly assume, as we have these last 10 years, that we shall automatically outperform the Russians. Their dramatic achievements in the field of missiles have opened our eyes. But just as impressive is their record of achievements in the area of economic expansion.

True these advances have been gained at the expense of the people's living standards. But even these are being improved. While Soviet production was 30 percent of total American output in 1950, it had advanced to 45 percent in 1957. The Soviet goal is to increase output by 60 percent in 7 years, an annual rise of 8.6 percent in contrast to rates of less than 2.5 percent being experienced in this country.

The absence of recommendations designed specifically to accelerate our rate of economic growth and production has left a yawning gap in the report which the witnesses before your committee must seek to close. The Joint Economic Committee should, therefore, consider both the structural changes necessary to assure economic stability which is the primary and central theme of the President's report and those which are necessary to expand production and accelerate economic growth.

The President's report appropriately recommends five changes in the administration of the antitrust laws which would restrain mergers as well as advance competition. These proposals have been considered by Congress and should be acted upon favorably.

Extensive hearings have been held on these proposals by both the Senate and the House committees for at least 3 years.

But by themselves, these proposals will not assure a more competitive pricing system and a more moderate pricing policy by the large oligopolistic corporations. Moderation of these price policies will only be achieved through deliberate administrative review. Producer and interproduct competition will not by themselves force the reduction of prices in these areas.

The President's admonition to the "leaders of labor unions" that their economic actions must reflect an awareness that stability of prices is an essential condition of sustainable economic growth is misplaced. Trade-union leaders and members are well aware that inflationary trends do not benefit workers. They have sought ways to minimize the price increases but their efforts have been rebuffed. Organized labor has been repeatedly told that prices are not proper subjects for collective bargaining. We can trace the controversy on that subject back to the great strike of 1946 in the automobile industry. That challenge to big industry has been repeated time and time again, but to little avail. Management refuses to yield.

I know in my own union in June 1948 we made the same appeal to the textile industry. We asked the employers to reduce their prices and offered to waive our demands of wage increases if they would do so. We have had other similar exhibits, the most dramatic of which was last year when the auto union petitioned the industry for a hundred dollar reduction in car prices and assured its wage policy would be adjusted thereafter. But all of these, as indicated, and many others, have not been answered, and outrightly rejected, either directly or by sheer silence. When unions have offered to trim their wage demands in exchange for price reductions, their overtures have been rejected.

The control of the price levels in this country cannot begin with remonstrances to the trade-union movement. No matter how restrained or conservative the trade union may be in its wage demands, managements will remain free to charge whatever prices they feel the market will take and those which conform to their own profit and market targets.

Trade-union wage objectives are in fact derived demands. They reflect the degree of profit already attained by employers. They are protests against the avaricious price policies. Workers' demands arise from requests for shares in high profits employers have already garnered. Any national policy which effectively moderates the price policies followed by management will automatically be reflected in a corresponding diminution in trade-union wage objectives.

Representative REUSS. May I interrupt at this time to say that your paper, as submitted will, of course, without objection, be made part of the record. Because of the time limitation, I am wondering if you could cover the high spots of your paper, orally. Particularly I think we would be interested in your spelling out the section called Structural Changes Requiring Long-term Growth.

Mr. BARKIN. Very well. I assume the entire paper will be reproduced in the record?

Representative REUSS. Without objection, it will be made part of the record; yes, sir.

(Mr. Barkin's entire statement follows:)

STATEMENT OF SOLOMON BARKIN, DIRECTOR OF RESEARCH, TEXTILE WORKERS UNION OF AMERICA

The President's Economic Report recognizes several structural defects in our economic organization. But a more far-reaching analysis and prescription are required if we are to attain the degree of stability and economic growth to which we, as a Nation, aspire. We would agree on its own merits with the general emphasis on the need for a stable price level. But we do not believe that there is any value in or necessity for adding an explicit directive to this effect. On the contrary, its insertion at the present time in the preamble of the Employment Act would tend to subordinate, as the present administration has already done, the objective of maximum employment to that of price stability, which emphasis we do not condone.

Furthermore, this stress on price stability also tends to minimize the objective of economic growth. While the Economic Report speaks confidently of our economy having achieved a significant victory over the recession, it is quite vague about the Nation's future growth pattern. It makes no affirmative declarations of goals. There is a complacency about the rate of growth which is ill suited to the tempo of our times.

The report is practically silent about the economic battle to which Khrushchev has challenged us. This is a type of cold war to which we should respond. We should bend our every effort to shape our economy to win and best the Soviet system in this competition. But the report is silent on this subject and fails to make any recommendations to the Congress on basic legislation necessary to improve our economic structure so that it may better outdistance the Red contenders.

Unfortunately, we can no longer smugly assume, as we have these last 10 years, that we shall automatically outperform the Russians. Their dramatic achievements in the field of missiles have opened our eyes. But just as impressive is their record af achievements in the area of economic expansion. True, these advances have been gained at the expense of the people's living standards. But even these are being improved. While Soviet production was 30 percent of total American output in 1950, it had advanced to 45 percent in 1957. The Soviet goal is to increase output by 80 percent in 7 years, an annual rise of 8.6 percent in contrast to rates of less than 2.5 percent being experienced in this country.

The absence of recommendations designed specifically to accelerate our rate of economic growth and production has left a gnawing gap in the report which the witnesses before your committee must seek to close. The Joint Economic Committee should, therefore, consider both the structural changes necessary to assure economic stability which is the primary and central theme of the President's Report and those which are necessary to expand production and accelerate economic growth.

### ECONOMIC STABILITY DEMANDS RESTRAINT ON INFLATIONARY PRICE POLICIES

The President's Report appropriately recommends five changes in the administration of the antitrust laws which would restrain mergers as well as advance competition. These proposals have been considered by Congress and should be acted upon favorably. But by themselves, these proposals will not assure a more competitive pricing system and a more moderate pricing policy by the large oligopolistic corporations. Moderation of these price policies will only be achieved through deliberate administrative review. Product and interproduct competition will not by themselves force the reduction of prices in these areas.

The President's admonition to the "leaders of labor unions" that "their economic actions must reflect awareness that stability of prices is an essential condition of sustainable economic growth" is misplaced. Trade union leaders and members are well aware that inflationary trends do not benefit workers. They have sought ways to minimize the price increases but their efforts have been rebuffed. Organized labor has been repeatedly told that prices are not proper subjects for collective bargaining. When they have offered to trim their wage demands in exchange for price reductions, their overtures have been rejected.

The control of the price levels in this country cannot begin with remonstrances to the trade-union movement. No matter how restrained or conservative the trade union may be in its wage demands, managements will remain free to charge whatever prices they feel the market will take and those which conform to their own profit and market targets.

Trade-union wage objectives are in fact derived demands. They reflect the degree of profit already attained by employers. They are protests against the avaricious price policies. Workers' demands arise from requests for shares in high profits employers have already garnered. Any national policy which effectively moderates the price policies followed by management will automatically be reflected in a corresponding diminution in trade-union wage objectives.

The Economic Report highlights the importance of five proposals designed to forestall further mergers which contravene the purpose of present acts and to facilitate enforcement of cease and desist orders under the Clayton Antitrust Act.

These moves will hardly be adequate to stop the aggregation of economic power. Further study is required of the increased growth of conglomerate mergers. They are creating large, dominant, economic organizations which spread their influence and power over many different industries. Since competition is no longer a significant determinant of price levels, these major corporations are able to extend their controls and dominance over many different products. It is questionable whether any special economic benefits accrue from this extension of control. The prestige of size and the extension of power and control appear to be the primary objectives.

One other phase of this same merger movement may be found in the trading of companies with loss carryback credits. What was originally designed as a procedure for helping a company average out its good and bad financial years has turned out to be a technique for trading in loss offsets against profits. The tax benefits are exploited by persons other than those who had incurred the loss. Profitable companies are seeking out loss situations and merging with them for the tax advantages they will gain. In most instances, the persons or corporations which obtain such businesses have discouraged the rehabilitation of the businesses and have proceeded to liquidate part or all of the loss corporation's assets. Though these persons had not suffered any losses they have avoided taxes on their profitable businesses by applying the loss carryovers of the liquidated corporations against the profits of the successor corporation. Concentration is encouraged and large business interests are enabled to feed at the public expense (app. A).

The inadequacy of the five-point program for implementing competition is dramatically illustrated by the results of the Bureau of Labor Statistics study of price flexibility. Of 1,789 items studied, 20.7 percent had reported no more than two price changes in a 3-year period. Of this number 95 showed no price change; 136, one change; and 139, two changes. The groups with the highest price increases between 1947 and 1956 were those which reported three to four or five to seven prices changes in the 3-year period. The lowest price increase was recorded in the industries with the highest price flexibility. (U.S. Senate, 85th Cong., 2d sess., Joint Economic Committee, "Frequency of Change in Wholesale Prices—A Study of Price Flexibility by the U.S. Department of Labor, Bureau of Labor Statistics," Washington, 1958, p. 4.)

The major challenge is, therefore, to find some system of review which would tend to moderate existing price formulas followed by the large, oligopolistic industries. Three courses of action are needed. The first is a determination whether any of the very large corporations have passed the point of economic utility and to enforce the spinoff of some units. The second is the Federal incorporation of the large businesses so that there might be more uniform reports and information required of them in the public interest. These companies should not only publish financial statements but should also be required to disclose their policies and decisions respecting production, new products, new acquisitions, research, financing, labor, and other phases of their operations. Third, the large Federal corporations should be required to inform a Federal supervisory agency of prospective changes in prices. The agency would be empowered on its own motion or on public petition to hold hearings and publish findings concerning its views of such price proposals.

I have also urged that there be an annual labor-management leadership conference, including representatives of agriculture and outstanding public personalities, which would discuss the economic policies followed by our private interests, seek to evaluate them in terms of the public interest, and reach a concensus concerning the principles which private enterprise should follow in its daily conduct and behavior to the constituent parties of the economy.

### STRUCTURAL CHANGES REQUIRED FOR LONG-TERM GROWTH

The creation of the above structural changes in our economy would help considerably to enforce competition and moderate the inflationary price policies now followed by many large corporations. But these are hardly adequate to achieve full economic growth. Rising prices are the result not only of excessive power, but also the byproduct of a sluggish rate of growth. Where high costs are not offset by rising productivity, the full weight of higher costs is passed on to the consumer in these sectors.

The President's Report exhorts business to "wage a ceaseless war against costs" and urges all groups to "wage a relentless battle against the impediments to the full and effective use of our human and technological resources". But the report outlines no specifics to direct the parties. There is an implicit assumption that no vital change is required in our industrial structure or that no new institutions are necessary to help in this battle. One of the grave omissions in the report is the failure to come to grips with this issue. Are we institutionally equipped to meet the Russian challenge?

Any analysis of the problems of our economy will immediately disclose that there are distinct structural gaps which must be closed for us to impel an adequate rise in productivity. The private economy as now organized is not adequate to meet this test. New institutions and agencies and Federal assistance are required.

One of the difficulties in our economy is that private enterprise does not tend to undertake tasks in which the risks are extraordinarily great or in which the returns are likely to be long delayed. We are not always aware of the fact that private enterprise becomes most effective when the major social investments have been completed. A private concern is unlikely to undertake them, except in unusual circumstances as in the development of isolated raw material resources.

In our international development we have learned this lesson. The present administration, which began its foreign program with the slogan "trade not aid," has slowly veered its financial assistance program back to the original outline by providing governmental loans for many important social investments needed before any private undertakings can be initiated. Private enterprise works best when the Government has completed the requisite social capital investments.

We, in our country, have acted more intelligently than we have often spoken. We have assigned many functions to Government because we have learned that they were necessary to the effective operation of a private enterprise economy. It required the large investments in TVA and waterways, dams and roads to open up the opportunities for private enterprise in many areas. More than 50 percent of all of the research and development costs by industry in 1956 was financed by the Federal Government. Governmental expenditures probably accounted for 60 percent of all research and development expenditures in the United States. In fiscal 1960 it is expected that the Federal expenditures on research and development will themselves exceed $5.5 billion. This huge public investment in research and development has provided a base for a private research industry and for making private investments.

What is needed is careful examination of our economy to determine more precisely the places where new institutions are required to stimulate productivity and economic growth and to provide the necessary funds for starting these ventures. It is more than likely that such enterprises will stimulate private enterprise to new constructive efforts which it will be able to carry on with little or no additional public funds. The Government has the responsibility for stimulating the sectors of the economy which tend to be laggard. The Joint Economic Committee should systematically survey the economy to determine areas and industries where such assistance may help to energize lagging sectors.

## NATIONAL PRODUCTIVE CENTERS

There is adequate precedent for such work and enterprise. Interestingly enough, our foreign economic assistance program has been built upon this approach. We have insisted that foreign countries program their developmental work. As an ancillary to such projects we have encouraged the countries to establish national productivity centers. Their first responsibility was to awaken the constituent national groups to the needs for higher productivity. They then helped management improve its own performance. Later they helped humanize labor-management relations. Now they are engaged in bringing research tools to bear on the difficult areas within their economies and to stimulate the development of the most promising sectors. These centers have been widely successful and crucial to the economic revitalization of many European and other countries. It appears only proper that this country, which inaugurated these programs and helped finance them, should also initiate similar efforts at home in sectors where they might be helpful.

One sector of the economy where such a productivity center would be most useful is the services. Many have already commented that a substantial part of the increase in the Consumers' Price Index over the last few years is attributable to the unending rise in the service sector, as well as in local taxes. Little has been done in this country to promote systematically improvements in these areas. Vested interests, the highly decentralized nature of the decisionmaking centers, and often the smallness of the individual units makes it difficult to promote adequate efforts at study, analysis, and experiment for developing new procedures for higher productivity.

In a previous document submitted to your committee, I illustrated the problem in terms of medical costs. Similar analysis may be made respecting transportation, housing, education, recreation, and other phases of the services. There is a pressing need for action. No effective program can be taken by our Government toward stabilizing the Consumers' Price Index until we initiate large-scale efforts at increasing productivity in the service industries. A productivity center for the service industries appears as a reasonable approach to this end.

REDEVELOPMENT OF DECLINING INDUSTRIES

Another obvious area for concerted action is the declining industries. They include such huge sectors as agriculture, textiles, mining, and railroads. While these are sick, our Nation cannot enjoy maximum production or fully utilize its resources and manpower. The correction of these maladies and reinvigoration in these areas must be systematically pursued. Our national interest in them flows from the fact that they employ millions directly, and many more indirectly. Many communities depend upon their economic health. Billions of dollars in public and private capital are tied up in them.

Some of these industries are well organized and have formulated programs for growth. Others are not organized and have rejected the idea of planning and systematic investment in new research. Still others do not have the resources and are not well organized for financing their expansion of markets and uses.

The principal emphasis in this paper is upon the needs of declining industries and the need for institutions which will reinvigorate them and stimulate their growth. The purpose is not to maintain inefficient industries, but to help revitalize them through research for new products, markets, and internal organization. Illustrative of their approach is the Commission on Increased Industrial Use of Agricultural Products, which proposed a whole series of research projects designed to broaden the market for surplus agricultural products and to develop new crops to diversify current output. In the course of its report it indicated that the agricultural industry was not itself set up to finance such research. However, there are various tax or payments systems in force for individual crops through which some funds may be assessed. Little of this research would be done unless it was in whole or in part financed by the Government. In fact, there were many research findings available which showed great promise which awaited pilot demonstration to make them fully feasible on a commercial basis (U.S. Senate, 85th Cong., 1st sess., "Report to the Congress From the Commission on Increased Industrial Use of Agricultural Products." Document No. 45, Washington, 1957).

A bill is being currently offered to promote more extensive research in the coal industry (S. 49). Similarly, the Senate Interstate and Foreign Commerce Committee has completed an investigation into the textile industry. During the course of these hearings, the Textile Workers Union of America proposed a textile redevelopment agency to stimulate research into new products and markets and otherwise broaden the vistas of the industry's leaders so that they find new roads for expansion within the domestic market. Various Federal, administrative, and congressional agencies are considering problems of our transportation industry to bring more order into this field. Each of these efforts ultimately means the reinvigoration of an older industry with consequent removal of barriers to economic growth.

We have already seen other older industries reassume their growth after periods of stagnation. The paper and pulp industry was revitalized by research. Others can be similarly stimulated.

Another sector of our economy which requires direct attention if we are to moderate the rise in the consumers' price index and improve our daily living, is our local government. The spawning of suburbs has created a maze of local authorities with endless conflicts over air and water pollution, zoning, transit and highway location, to mention only a few areas. The communities often find solutions for their own problems at the expense of a neighbor. Inefficient land utilization is commonplace; costs are constantly rising. And yet these communities often refuse to cooperate to find a common, voluntary solution. The large cities often deteriorate and the suburbs are being oppressed by high taxes. The great need here is also for a new institution which would help coordinate and hopefully bring voluntary agreements into effect among these communities. New institutions are needed to solve our new problems.

AREA REDEVELOPMENT

A third need for economic growth is assistance to the chronically distressed communities. There are, as of February 1959, 23 large labor markets and 59 small labor markets in this category. In addition, there are hundreds of rural underdeveloped counties. Most of these have made substantial efforts at redevelopment. But their continued inability to rise out of the state of chronic distress indicates that the local resources and institutions are inadequate. Here again, the judgment is that the rehabilitation of these communities is in the long run cheaper than their abandonment. Their revitalization is essential to economic growth. Programs have been submitted to the Congress to help these areas provide technical assistance, improve essential public facilities and construct initial industrial or commercial structures to initiate the growth process of recovery. This Federal assistance is vital, for local resources are often most depleted in these communities. They have been the backbone of the Nation's economy and now that their industries, which served as their mainstay have declined, they must be helped to redesign and redevelop their social-capital structures and to find the industrial and commercial patterns which would initiate renewed long-term growth.

CONCLUSION

Structural changes are required in our economy for us to advance stability and economic growth. Stability requires not only the promotion of more effective competition but also adequate public review of private policies and the breakup of the excessively large corporations which dominate our society and were constructed, like the holding companies in the twenties, primarily to satisfy the power goals of individual business leaders. An important step toward such action would be Federal incorporation of all large business enterprises.

A major step necessary toward stimulating economic growth would be productivity centers for economic sectors where productivity increases are lagging, for industries which are declining, and for areas which are chronically distressed. Private enterprise will not generally redevelop these vast areas or initiate major projects for advancing productivity. The Federal Government must shoulder this responsibility. Through such productivity agencies, dedicated to impelling economic growth in the backward sectors of the American economy, we can assure their rehabilitation and revitalization and substantially increase our national productivity and our rate of economic growth.

Mr. Barkin. I will make this summary comment.

I have set forth here the problem of the conglomerate merger, the problem of mergers due to loss carryback credits. And I have concluded that the major challenge in the light of the problem of administered prices by large economic corporations, and these two types of mergers, is to find some system of review which would tend to moderate existing price formulas followed by the large oligopolistic industries.

Three courses of action are needed. The first is a determination whether any of the large corporations have passed the point of economic utility and to enforce spinoff of some units within them.

The second is the Federal incorporation of large businesses so that there may be more uniform reports and information required of them in the public interest. These companies should not only publish financial statements but should also be required to disclose their policies and decisions respecting production, new products, new acquisition, research, financing, labor, and other phases of their operation.

Third, the large Federal corporations should be required to inform a Federal supervisory agency of prospective changes in prices. Then going to the structural changes.

The creation of the above structural changes in our economy will help considerably to enforce competition and moderate inflationary price policies now followed by the large corporations. But these are hardly adequate to achieve full economic growth. Rising prices are the result not only of excessive power but also the byproduct of a sluggish rate of growth.

Where high costs are not offset by rising productivity, the full weight of higher cost is passed on to the consumer in these sectors. We indicate that the President says in his report that people should wage a ceaseless war against cost. But the grave question is "Are we institutionally equipped to meet this challenge and is it likely to come to pass."

Any analysis of our economy will immediately disclose that there are distinct structural gaps which must be closed to impel an adequate rise of productivity. The private economy as now organized is not adequate to meet this full test. New institutions and agencies and Federal assistance are required.

One of the difficulties in our economy is that private enterprise does not tend to undertake tasks in which risks are extraordinarily great or which the returns are likely to be delayed. In our international development we have learned this lesson. The present administration which began its foreign program with the slogan "Trade, not aid" has slowly veered its financial assistance back to the original outline by providing governmental loans for many important social investments needed before private undertakings can be initiated.

In then proceed to indicate that we have learned this lesson piecemeal in many other instances. The most dramatic current one, of course, is the field of research where the U.S. Government provides the substantial proportion of 60 percent of all research and governmental expenditures in the United States.

Another illustration, of course, is to be found in the new small business investment structure, which Congress provided last year. What is needed is careful examination of our economy on a thorough basis to determine more precisely the places where new institutions are required to stimulate growth, productivity, and economic growth, and to provide the necessary funds for starting these ventures.

I think the Joint Economic Committee in this respect has a very special responsibility to make this overall systematic survey of the economy to determine the areas and industries where such assistance may help to energize lagging sectors and then make that information available to the people and the Congress so that the individual areas may be specifically considered for appropriate constructive action.

I shall now deal with those that I know or feel that the committee should immediately reflect on and consider.

I have not undertaken, in the short time I had over the weekend, to prepare this to make this list exhaustive. But this should be indicative. And I should be very happy if a special session of the committee were held to examine these structural gaps to make a more elaborate and detailed analysis of others that may exist.

First of all may I indicate the irony of our own development during the postwar years. We have fostered national productivity centers in most of the free countries of the world. We have financed them; we have sent our most advanced technicians, our scientists, our social scientists, as well as administrators. But we have been very reluctant to establish a comparable institution in the United States.

I was in Europe at the beginning of this month and found that men who are administering these productive centers in the four countries in which I visited are amazed at this curious phenomenon where we reject the very idea that we sold them.

I therefore urge that one of our greatest needs is for the creation of such a national productivity center.

(Mr. Barkin subsequently submitted the following for the record:)

NATIONAL PRODUCTIVITY CENTERS

(By Solomon Barkin)

The idea of a national productivity center has been most diligently pressed in European countries. As recovery was proceeding in Europe, many leaders became aware of the need of accelerating the rate of productivity increase through systematic methods. The advance was a most complicated one. It involved not only the acquisition of the scientific and managerial knowledge, but more importantly it demanded the will to obtain the information, the determination to apply it, and a widespread spirit of cooperation on the part of labor and various significant elements of the population. Productivity advance could not be achieved solely through entrepreneurial efforts. Moreover in the new state of social awareness a sound economic policy for distributing the benefits of the higher productivity, the achievement of a higher standard of living and a form of cooperative relationship with workers, also occupied a prominent part in such an effort.

The American Government fostered these programs through direct technical operation agreements with the individual companies.

Since the initial effort in Europe, such programs have now been developed in all OEEC countries. In fact these countries are now coordinated through the European Productivity Administration in a regular established manner (app. A). At a recent meeting of the heads of the various national productivity centers they defined the "concept of productivity and the aims of the national centers," which is attached hereto as appendix B.

Similar productivity centers have been established in other countries and in other forms. Among the productivity centers are those organized in China, Japan, Mexico, and Israel.

Industrial development centers and industrial institutes have been developed in the Philippines and Lebanon. These are usually joint agencies sponsored by the national government and the Government of the United States. The objective is the ultimate growth of a service corporation subject to the laws of the country and capable of operating largely on its own funds, which are derived from those who benefit from its services. They are distinguished by concentration upon specific technical advice and assistance to firms and organizations requesting their services. They are staffed with competent specialists available in sufficient quality and quantity to render efficient service to the country.

A third type of organization founded primarily in Latin America is the servicio which is usually established by the local and the United States Governments, but is not solely responsible to either. The program is determined by a board or council. The staff usually includes both American and national technicians. The U.S. technicians are responsible for inservice training of their counterparts and subordinate staff. In most instances it introduces and furthers the introduction of improved industrial methods, concepts, and techniques throughout the various services and resources at its command. It also has the duty of awakening general interest in the necessity for higher productivity, and stimulating effective and sound distribution of the fruits of greater production and increasing national economic strength and the standard of living of its people.

The United States also performs various other promotional activities for foreign countries. There are first team visits to the United States. Americans are sent abroad as industrial specialists. There are various technical aids furnished to other countries including the following: Technical Inquiry Service; Industrial Reports Service; Technical Digests Service; Technical Exhibits Service; Technical Film Service; Technical Literature Service; Training Materials Service; U.S. Book Exchange Service.

A full description of these agencies and their activities is to be found in a publication of the International Cooperation Administration entitled "Activities and Institutions of the Industrial Technical Cooperation Program."

We are attaching herewith a specific memorandum on the needs of a productivity center for the service industries and a draft of a project for a productivity center for an individual state (app. C and D).

(The appendixes referred to are in the committee files.)

Mr. Barkin. In the statement I point to the fact that one area where such a productivity center is greatly needed is the service industries. We all know that the service sector of our Consumer Price Index is the one that seems to be moving up without cessation, causing a constant increase in the Consumer Price Index. It seems that the President's committees that he has established in the administrative end are just not facing up in their instructions to the real challenges. No monetary or fiscal problems will correct or stem or stop the constant rise in housing costs and medical costs, in transportation costs, and the constant rise in local tax rates. These must be faced, and these can only be faced in the first instance by a careful examination of their structure, of their habits and methods of performance, in order to insure greater productivity. Often the smallness of the individual units makes it difficult to develop new procedures for higher productivity in this industry—in these industries.

We have learned this lesson: I think the Government has a responsibility. The second major area which I have noted here is the area of declining industries. Here again much work has been done and much more should be done.

In the statement here I deal at some length with agriculture and quote the report—to Congress in 1957 from the Commission on Increased Industrial Use of Agricultural Products.

Here is an illustration of a gap which—a structural gap in our economy. Because we cannot depend upon the small agricultural units to do the research or to collect the funds necessary for such research.

In my own industry, the textile industry, we have urged a textile development agency. And that issue is before a committee of Congress. The same thing is being done in the railroad industry. The same problem also exists in local government. We must approach these problems of structural gaps in our economy in order to stimulate productivity.

Finally, I make mention of a third gap, namely, the one in area redevelopment, with which you Congressmen are well acquainted and with which Senator Paul Douglas has been so intimately associated.

Then I conclude: Structural changes are required in our economy for us to advance stability and economic growth. Stability requires not only the promotion of more effective competition but adequate public review of private policies and the breakup of excessively large corporations which dominate our society and were constructed like the holding companies in the twenties, primarily to satisfy the power goals of individual business leaders.

An important step toward such action would be Federal incorporation of all large business enterprises. A major step toward stimulating economic growth would be the establishment of productivity centers for economic sectors where productivity increases are lagging, for industries which are declining, and for areas which are chronically distressed. Private enterprise will not generally redevelop these areas or initiate major projects for advancing productivity. The Federal Government must shoulder this responsibility. Through these productivity agencies dedicated to impelling economic growth in the backward sectors of the American economy, we can assure their rehabilitation and revitalization and substantially increase our national productivity and our rate of economic growth.

Thank you.

Representative REUSS. Thank you, Mr. Barkin.

Our next panelist is Mr. Padraic P. Frucht, economist, Chamber of Commerce of the United States. If you like, we can, without objection, make your statement part of the record, you may summarize it, or, if you prefer, read it in its entirety.

## STATEMENT OF PADRAIC P. FRUCHT, ECONOMIST, CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. FRUCHT. This statement summarizes the conclusions of a more extensive analysis and I would like to submit a supporting statement within a day or so if I may.

Representative REUSS. If you will send it in, we shall include it in the record. (See pp. 314, 764.)

Mr. FRUCHT. Thank you, sir.

My name is Padraic P. Frucht and I am a research economist with the Chamber of Commerce of the United States. I appear at the invitation of this committee in a personal capacity and not as an official spokesman for the national chamber.

I appreciate the opportunity to discuss with the committee and with this distinguished panel some of the major factors which may be likely to affect significantly our ability to maintain adequate levels of employment and rates of growth within a framework of reasonable stability of the general price level and free markets.

I propose to deal here chiefly with one element in the present debate—"administered prices"—and I will attempt to reexamine the nature and significance of this pricing mechanism for the purpose of making as clear as possible the kinds of policy issues we do and do not face. I will submit for the record a more comprehensive statement, going into the reasoning behind the conclusions stated here in summary fashion.

The term "administered prices" applies properly to all market situations in which individual firms set their own prices under conditions in which the level of prices charged, and the frequency of changes in the level, are influenced not only by changes in immediate demand and supply relationships, but also by each firm's concern for the effects of its short-run prices on its individual market situation in the future, however near or far.

While there are many different types of influences working to affect the relative flexibility of pricing, the only one which works systematically over the economy is the pressure of entry. Under perfect competition, where identical products are bought and sold in impersonal markets, the impact of entry is to increase price flexibility. But under conditions in which each firm's product is more or less differentiated from those of its competitors, the effect of entry is, paradoxically, to reduce price flexibility.

Let us see why this proposition must be so. We assume that product differentiation creates for each firm its own market, composed of attached customers who, because of loyalty or limited alternatives, will not transfer their demands, at least for a short while. But, over time, the demand of the individual firm is not independent of the prices it charges, for if its prices are above average, customers will seek other alternatives, and other alternatives will seek them.

In dealing with the methods and goals of rational economic behavior, and I assume this applies to business firms, the most simple assumption and usually the wisest to make is that the firm tries to make its decisions so that they will produce the most valuable possible flow of earnings over time to the firm. In the case of perfect competition, this injunction suggests that the firm should earn as large profits as possible at each moment in time. Such behavior will produce an income stream of maximum value, since the rational actions of the individual firm to earn as much as possible in the shortrun cannot, from its point of view at least, affect its longrun prospects but favorably.

Contrast this case with differentiated competition. Take, for example, a local drugstore—the only one in town. No other drugstore is quite like it from the point of view of its customers—who much dislike driving 10 miles to get a prescription filled. In the short run, our druggist is effectively a full-scale monopolist. He could raise his profit rate enormously if he took advantage of his own differentiated product market. Druggists are usually nice people who wouldn't dream of doing such a thing. But are the ethics of the druggist our only reliance here? Obviously not. If the druggist dared to take such advantage, we all know that very soon—a matter only of weeks or a couple of months—there would be another druggist in town.

The moral of the story is that every firm, from gasoline station to giant industrial company, producing products which are at all differentiated—physically, in terms of the goodwill of the seller, in location, or what-have-you, is in the position of the druggist. Its shortrun profit opportunities may be enormous, but like a sensible druggist, it knows that to take advantage of a shortrun market situation, which ostensibly belongs to him, by maximizing shortrun profits could ruin the company. A sensible price policy will enable the firm to hold its market—thus, it sets an "entry limiting" price.

Under differentiated competition, then, the firm prices in the short run so as to earn the largest profits possible, consistent with its longrun earnings potential. If it is an especially efficient competitor, or if it has market power to greater or lesser degree, its price will be calculated to get the maximum yield from these advantages.

But shortrun price, however costs and demand may be moving at the time, must not be such that over time it will attract such entry and/or lose so many customers so as to reduce the value of the firm's future expected earnings stream. To the extent that its ability to exclude entry is the less, and to the extent that its market can be eroded by entry and lost customer attachments, its pricing will be the more conservative.

As in the case of homogeneous product competition, entry where products are differentiated is the essence of the competitive discipline.

The rule of pricing under these circumstances is to determine a price which, given the expected behavior of existing or prospective entrants, will produce the maximum shortrun earnings consistent with maximum longrun earnings. But, if this is the case, why doesn't the firm just adopt a simple rule-of-thumb percentage markup over cost which will produce the best level of earnings that is safe—and be done with it? The answer lies in the surrounding circumstances.

Differentiation implies different cost structures and a different state of demand for each firm. It also implies different competitive attitudes and expectations on the part of the various competing firms. If costs are up, who is to raise first, and by how much? If demand is down, who is going to plunge the industry into a price war in which no firm can be sure of surviving? At what point does the differentiated firm make its move? These are hard questions to answer, and one can only state some relevant factors bearing on the decision by the individual firm to raise or lower its prices.

At any moment, each administered price firm has a given price—its entry-limiting price—in effect. This price, which is higher than minimum average costs by a factor which expresses the degree of shelter from entry—the firm's market power—is typically considerably less than the prices which would maximize profits in the shortrun.

If demand falls, the profits of the firm fall, but until or unless the best shortrun price falls below the limit price, the firm will have no great incentive to lower price.

An attempt to shift its market demand favorably at the expense of its rivals might take the forms of price cuts, but this will not be very successful in improving matters if the decline is general, causing others to pursue the same policy, or making them ready to retaliate if put under this pressure.

Pricing behavior in response to cost changes is generally less tentative and exploratory in nature than when demand changes. In general, when all firms are subject to similar cost effects, their price responses will be quicker than in the case of demand shifts. This follows in part from the effects of general industry knowledge that all firms are in the same boat.

Now—how does market power affect pricing responses?

The answers here are somewhat peculiar. Assume that the change in costs or demand is confined to a given industry. Analysis suggests that with greater market power, price responsiveness to cost changes is also greater. This intriguing conclusion is matched by its converse in regard to demand changes; here the lower the market power, the more responsive the pricing.

In an inflationary boom, the logic of administered pricing suggests that firms with strong market power will try hard not to increase price as their demand rises. This follows from the proposition that, prior to the demand increase, the firm was already charging as much as it dared in view of its evaluation of its own entry barrier.

A price increase response to the shift in demand would put the firm above its safe price and earnings point. So, the firm will hold the price line and expand output as much as possible, meanwhile pushing construction of new capacity if the outlook looks promising enough.

Under such circumstances, then, it would seem that the impact of increasing demand where administered pricing is used would be to bring greater increases of capacity and greater increases in output than a more flexible pricing procedure would create.

It can be asserted with considerable confidence that in a booming economy, there is no reason whatsoever to expect larger relative price rises per unit of time in response to demand increases among administered price industries. And the assertion can be made more strongly as market power is the larger.

But, in all seriousness, there is cold comfort in this proposition for any special interest. Because market power is placed in jeopardy when customers are left unsatisfied, the typical response of the administered price firm—that of increasing output at the limit price—is carried further by the firm which has strong market power than would happen in "perfectly" competitive industries with perfectly flexible pricing. Price increases in the latter would take place to choke off some of the added demand for output.

Whether or not its extra pressure to increase output places the firm in an awkward cost position as it strains its capacity, it does result in a greater output level than if the price response were more like that of perfectly competitive industries.

This, in a booming economy, can only mean pressure on factor costs in excess of what flexible pricing would have generated. These cost increases will be fairly quickly reflected in higher prices by the given firm, and by other firms in the same labor markets whose costs are jolted up by this pressure. So, the retarding effects of administered pricing on inflation may prove to be of minor significance.

One important influence may remain. The barriers to entry confronting a given firm are not insensitive to cyclical and expectational influences. Entry becomes a negligible restraint during economic decline on firms with substantial market power. Conversely, in economic booms, entry becomes a greater threat and this should be reflected in highly cautions pricing responses to demand increases.

My analysis suggests that while administered pricing adds no steam to inflation, it likewise does little to cool it down. Perhaps the main objection to administered pricing as such should be made from a view to its effects during economic decline. But even here it is not obvious that increased downward flexibility in pricing would be particularly desirable.

The problem of market power is a different one from that of administered pricing, per se. Regardless of what we do or don't do about market power, whether in business or in union hands, it can be said with authority that administered pricing and its relative inflexibilities are here to stay.

So long as we all want diversity in products, which means differentiation, we will have administered pricing. And though one would prefer to have the benefits of differentiation without paying for it with loss in price flexibility, it would hardly seem appropriate, as some have recommended in the name of flexibility, to replace "administered pricing" autonomy with price controls which would, by their nature, preclude almost all price flexibility.

I would like to say that apart from the matter of administered pricing per se, there seems little reason to suspect that market power in the hands of business is directly responsible for inflation. The evidence is highly inconclusive that the entry barrier would go up under inflationary conditions. The evidence points the other way.

I would like to go further and say that the evidence is likewise inconclusive about the role of union power, or labor power in the market place, as far as setting loose or initiating direct inflationary pressures.

One of the major problems that inflexibility in business pricing and in wage movements creates for the economy is this: A dynamic and growing economy in which the composition of demand in the total national bill of goods is shifting about from industry to industry and from region to region, must generate inflation as the demands shift, if, as increases in demand occur in one place, they are not offset by decreases in price in the other place.

We can have, in other words, a ratchet inflation due to the fact that as prices go up in an industry or area in which demand is growing, they fail to go down in the industry or area where demand is falling.

Under these circumstances, with essentially full employment in the economy, it could be quite possible, without requiring market power of any consequence in the hands of business or unions or even without unsound governmental fiscal and monetary policies, to get an inflationary spiral out of successive dynamic changes in demand.

Thank you.

Representative KILBURN. Thank you very much.

(Mr. Frucht's prepared statement follows:)

### "ADMINISTERED PRICES" REEXAMINED

(By Padraic P. Frucht, Economic Research Department, Chamber of Commerce of the United States)

#### INTRODUCTION

Business organization, the structure of markets, the private pricing practices have long been matters of public interest and policy concern. Our antitrust history testifies to this fact. But, in addition to traditional problems of monopoly and restraint of trade, these matters have assumed a new importance in recent times in relation to problems of economic stability and growth. More specifically, attention has been focused on "administered" prices and wages as "causes" of inflation or as impediments to public policies designed to promote adequate levels of employment and rates of growth within a framework of reasonable stability of the general price level and free markets.

In spite of the clouds of loose thinking and irrational verbiage about "administered prices" and "wage inflation" which have hung like a heavy smog over public discussion of these issues, it is of vital importance that policymakers assess the potential success of public stabilization measures in light of the institutional structure of product and factor markets to which they are applied.

But current discussion of these issues have been dominated by a barrage of highly subjective and supercharged, partisan interpretations of piecemeal bits of evidence. These "intuitions" have failed to meet any objective test of logical consistency or coherence. While much free-wheeling eclecticism can often be most useful in bringing important real problems to the light, it should not in itself form any basis for legitimatizing loose thinking in formulating economic and social policies. For this reason, a systematic, logical framework for the analysis of market structures and their implications for pricing behavior is needed if we really want the air cleared and the real problems in this area highlighted.

This statement deals chiefly with one element of the present debate—administered prices. It attempts to reexamine systematically the nature and significance of administered prices for the purpose of making clear the kinds of policy issues which we do and do not face.

The term "administered prices" has many meanings and connotations. In part this confusion indicates a dissatisfaction with the conventional tools of economic analysis in explaining the complexities of business behavior in the real world. This dissatisfaction is not altogether unfounded, though it has been much too sweeping in its application. Conventional analysis does give clear and unambiguous results for extreme cases: (1) perfect competition, where a homogeneous or undifferentiated product is involved, and (2) pure monopoly, where one firm or decision-making entity has exclusive and excluding control of the market for a product having no close substitutes. But, in between the extremes—where products are differentiated, where there are sometimes few, sometimes many sellers, where entry of new competition may be difficult or easy, where market adjustments may be slow or rapid, where diversity seems to defy simplification—conventional tools of analysis do not always provide the clear, rigorous generalizations which we would like to have in answer to the questions.

Because of this unsatisfactory state of affairs, economists are now in the process of developing some new approaches. This does not involve any scrapping of received economic doctrine, which, for most of the questions on business behavior which concern us, remains our clearest and soundest approach. The question at issue in the administered pricing debate requires us to deal systematically with questions regarding pricing inflexibilities, which, however, are explicitly excluded from consideration by the assumptions of more orthodox economic theory. For this reason, we may find it conducive to a clearer understanding of the administered pricing issues to redirect the traditional tools toward more relevant distinctions and assumptions about the forces which shape business pricing decisions.

Part of what follows is old and part is new. Important contributions by Professor Edward Chamberlin, for instance, have made economists face up to the fact that some aspects of business behavior cannot be easily reconciled with the more orthodox image of economic reality.[1] Though the specific approach adopted by the author has been developing over a period of time in teaching and research, it owes much to the creative work of Chamberlin and Joe Bain[2] on these problems. Because some features of the analysis are relatively new and unfamiliar, the argument is developed in considerable detail. The length of this statement will be justified if it helps to clarify some "administered" confusion and throw light on the policy issues which seem to be involved.

## PRELIMINARY CONSIDERATIONS

### *The relative flexibility of products and prices*

More mischief is done by the careless habit, shared by most of us, of assuming that products are definite physical entities, that services can be measured in precise units. A steak may be well or badly cooked, the restaurant clean or dirty, handy or inaccessible. Few defendants at law assume that one lawyer is as good as another.

Products and services have many significant dimensions which influence our dispositions to buy from this or that seller or producer. Along with its central core of physical characteristics, qualities or performance, the product package

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[1] "The Theory of Monopolistic Competition," Edward Chamberlin; Cambridge, Mass.: Harvard University Press, 7th edition, 1956.

[2] "Barriers to New Competition," Joe S. Bain; Cambridge, Mass.: Harvard University Press, 1956.

The contributions of Professor Bain, along with the important work of Paalo Sylos by Franco Modigliani in a recent article. See his "New Developments on the Oligopoly Labini in administered pricing theory—"Oligopolio e Progresso Tecnico" (Oligopoly and Technical Progress); Milan: Guiffre, 1957—are discussed with enthusiasm and perception by Franco Modigliani in a recent article. See his "New Developments on the Oligopoly Front," the Journal of Political Economy, vol. LXVI, No. 3, June 1958; University of Chicago Press; pp. 215–232.

Additional applications of administered pricing theory may be found in "The Nature of Administered Pricing," Economic Intelligence, vol. XI, No. 7, July 1958; Washington, D.C.: Chamber of Commerce of the United States; and "Product Competition" (ch. 20), "The American Economy," George W. Zinke; New York, N.Y.: Ronald Press; 1959.

includes all the terms and conditions of sale, locational accessibility and other factors relating to the buyer's convenience. The reputation and personality of the seller, his agents and premises—his good will—may be of primary importance.

Most of the dimensions of the product package possess some degree of economic value to the buyer, though the relative valuations by different buyers of the different elements involved may vary greatly.

Since most elements of the package are costly to create and to maintain, sellers are constantly reappraising and changing the elements in their product packages in the light of their costs and consequences in sales. Thus, it is quite possible for a product price to remain fixed over a considerable time while the product package itself changes radically in its composition and value.

Although we are not here concerned with the economic effects of competition in quality and other nonessential aspects of product packages, we must take cognizance of the fact that such adjustments as these render product price statistics less than accurate reflections of the relative flexibility of many prices. For this reason, comparisons of the frequency of price changes among industries can be misleading, unless supplemented by evidence on the other aspects of product packages.

*Factors influencing flexibility of posted prices*

Before turning to the analysis of administered pricing, it would be worthwhile to remind ourselves that the frequency of price adjustments depends fundamentally on many factors, of which entry is only one. Some of the more obvious of such influences on relative price flexibility should be mentioned:

(1) The frequency of factor price changes. A producer hiring many kinds of labor skills in a tight labor market would be more affected by changing wage rates if none of his workers were unionized than if each skill were in a craft union; the frequency of factor price changes in the latter case would probably be greater than if his workers were members of an industrial union.

(2) The special circumstances of the particular market—its institutional mores and customs, its merchandizing patterns, model changeover rates, the expenses involved in changing prices, etc.

(3) The relative importance of variations in product packages, quality competition.

(4) The degree to which posted prices are actually paid.

(5) The rate of technological change.

(6) The relative newness of the product and the rate of change in its output.

(7) The degree to which import competition is significant.

(8) The degree to which governmental policies and programs affect pricing and wage policies.

(9) The importance and role of product differentiation among the firms.

(10) The seasonal and cyclical sensitivity of product demand.

(11) The importance of competing substitutes and their frequency and direction of price changes.

(12) The ratio of fixed to variable costs.

(13) The speed at which new capacity can enter.

(14) The degree of variation among the firms in their cost structures and in the relative behavior of their factor prices.

(15) The variation in factor combinations among the firms.

These factors condition the pricing behavior of all industries. The force of each one may vary greatly from industry to industry and from time to time, however, and we would expect a priori that relative price flexibility would differ considerably among industries in any given time period. Furthermore since many of these factors are subject to change over time for any industry, we should not be surprised to find the relative frequencies of price changes among industries changing considerably from time to time.

But, among these influences is one which, wherever it exists, acts to induce some rigidity in pricing regardless of how the other factors apply and regardless of how costs and demands in an industry may be moving. This basic influence is product differentiation, which always acts to prevent immediate pricing adjustments to changes in circumstances.

ASSUMPTIONS

The analysis of administered prices which follows rests on the following realistic assumptions:

(1) That product differentiation which is prevalent over wide sectors of the actual economy implies that each firm has, in a sense, a market of its own, but that the ability of a firm to exploit its market is subject, in varying degrees, to the constant threat of entry by actual or potential competitors.

(2) That each firm attempts to maximize its profits, but that the time horizon of the firm is sufficiently long that profit maximization in the short run will be constrained by longrun profit considerations.

On the basis of these assumptions, a theory of "limit pricing" will be developed which says in essence that the prices of all firms producing differentiated products, with or without market power, are determined at any moment in time by the conditions of entry into each firm's market as well as by costs and demand. In other words, the focus of attention is how market constraints discipline the firm as it carries out its longrun, profitmaking functions and, in particular, how longrun considerations affect shortrun price and output decisions.

As used in this analysis, the term "administered prices" properly applies to all market situations in which the individual firm sets its own prices under conditions in whch the level of prices charged and the frequency of change in the level of prices are influenced not only by changes in demand and factor costs, but also by considerations regarding the effect of pricing policies on the firm's market situation in the subsequent time periods.

This definition, it should be noted, excludes the "auction prices" of perfect competition involving homogeneous products. It does cover all other cases where some degree of "differentiated competition" exists. It should be further noted that this definition implies nothing about the market power that individual firms may or may not possess. The implications of market power will be dealt with subsequently, but our first task is to examine rigorously the systematic influences which affect all "administered price" firms. This is attempted by means of an analysis of pricing behavior where the products of each firm are differentiated, but no barriers to entry by existing or new firms into any other firm's market exist. This case, therefore, is one of the most intense competition. After studying this case, it will then be possible to make an assessment of the probable influence of market power on observable price behavior and of the policy implications of such behavior.

*Identical versus differentiated product competition*

Despite the many influences operating to prevent or reduce price rigidities, administered prices are considerably less flexible than the auction prices encountered where there is identical product competition. This relative inflexibility appears to be the result of the combination of product differentiation among business firms and the pressures of actual and prospective entry. Entry is the most essentially competitive influence in the economy, working as systematically throughout the entire administered price sector as in the competitive auction price sector of our economy. However, there is a significant difference in the way this vital factor operates in the two cases.

Under identical product competition, the probabilities of entry of new capacity which would unfavorably affect its own profits cannot be influenced by the actions of the firm, nor does the firm consider the effects of its own behavior on prices. In the case of product differentiation, however, at each point in time, the firm must take into account the fact that entry into its own market can be influenced by its pricing decisions. In other words, the pricing policies of the firm will, perhaps dramatically, affect the future earnings of the firm. Furthermore, it is noteworthy that the entry which disciplines the differentiated producer need not involve new capacity; it may primarily take the form of market invasion by already existing rivals. A further difference exists: Under identical product competition, it is primarily the actual entry of new capacity which disciplines competition; under differentiated competition rather similar policing effects are obtained as much by the threat of entry as by its actuality. In this sense, highly competitive diffentiated product industries could be meaningfully described as even more competitive than identical product industries.

These differences underlie significant differences between the pricing mechanisms which apply. While competition or market power with identical products result in instantaneous price responses to cost or demand changes, competition and market power with differentiated products produce relatively inflexible limit pricing and behavior.

### "PERFECT" DIFFERENTIATED COMPETITION

Let us analyze, initially, the pricing behavior of firms which, while producing differentiated products, are subject to the most vigorous competitive pressures. We assume that each firm produces only one product, which is differentiated in some manner from those of its competitors, if only slightly. Quite accurate knowledge about competitors' earnings, sales, and capacities is assumed to be in the hands of each firm. Each firm has a given output capacity. Given the degree of differentiation (or relative customer attachment to its product), the firm must set or administer the price which in its own estimates will be most profitable. We assume that there are no barriers to the entry of new firms or existing firms into the market of any firm. Under these circumstances, the price of any firm cannot be set above the level that will produce normal profits (unless its efficiency is above normal) without its eventually suffering serious erosion in its sale. We assume, however, that some greater or lesser period of time must elapse before entry takes place. The rate of erosion of such a firm's market will depend on its product differentiation and on the behavior of its rivals, who may be expected more and more actively to seek to attract its customers as the product price is raised higher and higher. Our firm, thus, has a number of price alternatives, each with different consequences for the behavior of its earnings over time. Selecting a price policy that will produce optimal profits is a critical problem for such a firm, since a bad error on this could wreck the firm's future earnings potentials.

*Longrun profit maximization*

Since the firm endures in time and uses economic resources capable of earning profits for the firm in alternative uses or through investment of their proceeds on sale, profit maximization as the central goal of the firm implies that the firm acts so as to maximize the present value of these resources. This means that in making decisions the firm will use its best judgment in selecting from its policy alternatives those which may be expected to produce that flow of future income worth most from the viewpoint of the present. The expected flow of income connected with each policy alternative is implicitly corrected by allowances for the risks and uncertainties judged to be associated with it.

Given the income flows believed to be associated with each price, the value of each flow of expected income is explicitly or implicitly calculated from the point of view of the present. This is done by discounting back to the present the expected income of each future period at the interest rate at which the firm may borrow capital. (The present value reached is analogous to the value of an annuity yielding the given payment flow.)

The goal of selecting output levels with given capacity which will produce maximum profits at each moment in time dominates perfect identical product competition and monopoly situations. Economists term this approach "shortrun profit maximization." Under the conditions applying in these two above cases, shortrun profit maximization is required under longrun maximization. In our discussion we shall refer to the price selected on this basis as shortrun price. Longrun considerations occupy the stage at the same time as shortrun tactics are being implemented, but primarily these involve a recurring decision as to whether or not to make a change in capacity or technology. Such longrun decisions do not affect the adjustments and accommodations made by the firm to its current market circumstances, however.

On the other hand, since we wish to find an approach which will help us to explain a number of vital aspects of the pricing behavior of most firms as we find them in the real world, we find it more useful to adopt an approach which stresses the significance of longrun strategy for constraining shortrun tactics.

It should be noted that, since risk calculating of possible income flows is a highly subjective matter, different firms, even in highly similar circumstances, may choose different longrun policies or strategies with quite different shortrun consequences. But, competition, to the degree that it is effective, acts to reward or penalize and constrain these individual differences, so that actual business behavior among rivals works out to be more similar than might be expected offhand.

The problem of choosing the best price policy is so critical for the differentiated competitor because his price affects not only his present sales but also, and much more significantly, his future sales. The essence of his pricing problem lies in those factors responsible for the difference between the price policy which will yield the maximum profits in the short run and that which will maximize his longrun profits.

*Time periods*

For purposes of clarifying the central issues of the longrun and shortrun pricing alternatives, we define two time dimensions for pricing decisions:

*The short run.*—This is the period in which the firm's market will remain intact whether the firm increases or decreases its price relative to its actual or prospective competitors.[3] Within this period the firm has its market to itself and, thus, faces a demand schedule which falls to the right. If the differentiated firm raises its price to exploit its shortrun market situation, it could usually increase its shortrun profits—even though it would sell less. This shortrun period ends when entry begins to erode the market of the firm. The period of time covered by the shortrun may be long or very short: A matter of days, weeks, or months depending on the complex of interrelations among such factors as the speed at which market penetration by rivals could take place, quickness of entry, and the relative change in the firm's price.

Loss of the firm's customers, whose preferences for the firm's product are embodied in the shortrun demand schedule, may be the result of active invasion of its market by old or new competitors, or may simply be the result of an induced revision of preferences by the customers. Since the effects of market invasion and loss of customers whose preferences change are the same from the point of view of the firm contemplating a change in its relative price, we lump both factors under the term "entry."

Let it be emphasized that entry includes all market developments adverse to a given firm's future sales, which in the opinion of the firm could result from reactions to its pricing policy. Our purpose is not to imply that firms always make correct judgments as to these relations; we only emphasize that such judgments are made and result in relative inflexibilities in pricing behavior. Nor does it matter whether from the point of view of a given firm the relevant entry consists of new entering firms producing products of similar physical characteristics, expansion by existing rivals in capacity and/or greater sales efforts in the given firm's markets, or building up of the position of substitute products. Entry is a many-dimensioned threat and any or all of these types may operate to restrain the pricing behavior of a given firm. This restraint results in entry limiting price policies, in which prices do not adjust to changing costs and demand with the speed or the range to be expected on the basis of traditional competitive or monopoly models.

Separation out of these types of entry is required in analyzing the changes in industry capacity resulting from general changes in industry demand or costs. (Distinctions here may also be useful when we deal with cases where significant market power exists. While firms with low market power may be far more concerned with entry by existing rivals than of new capacity, the reverse may be the case where strong market power is held.)

*The long run.*—Under our assumption of perfectly free through not immediate entry, the consequences of short-run prices which yield more or less than normal profits for the perfect differentiated competitor of average efficiency can be grave. Any price above that which will yield normal profits to such a firm when it is operating at minimum cost output levels is too high. After the short-run period of grace, this would result in the loss of customers and active entry by other firms scenting a situation of vulnerability. Such firms may seem to have market power in the short run, since short-run profits could be very high, but the entry corrective is too powerful for such exploitation to take place.

Perfect differentiated competition means that the firm must learn to price at the level which yields normal profits on sales which fluctuate about its lowest unit-cost output level, or get itself into real trouble. The problem of finding the appropriate price is intensified by the fact that sales in a given firm's market will normally fluctuate in some erratic fashion from day to day and week to week. Under this circumstance the firm may experience difficulty

[3] We use here a demand schedule based on the principle that other prices do not react in this short run to changes in a given firm's price and output. Basically, it is Chamberlains' "dd" function.

in determining that its market demand is shifting in a more systematic sense. Since wrong judgments here may prove serious, the differentiated competitor will not even contemplate a change in price until he has a clear idea of his actual sales trend.

Should a firm's particular differentiation characteristics meet with especial market favor even when it is pricing correctly, the firm will have a choice between expanding its capacity—while maintaining in the interim the appropriate safe price—or else of letting entry take place. Since the gap between price and minimum average unit cost is necessarily small under these competitive conditions, even a small increase in output levels beyond the minimum unit-cost point will reduce profits significantly. Under these circumstances, the firm's longrun expectation of normal profits on its investment will leave the question of appropriate size to be determined by the interests and capabilities of the particular entrepreneur involved, in the light of the technological considerations implicit in the nature of product differentiation.

Actual industries, which even remotely resemble the conditions here discussed, could only be so structured by virtue of the tremendous pressures placed on the entrepreneur. The scatter in firm size we find in such industries in our economy expresses both the effects of differential entrepeneurial capabilities and the different technological characteristics of particular forms of differentiation. Under unusually able entrepeneurs, firms may earn much more than normal profits, though pricing at normal levels. Such firms can and should expand until additional investment adds only as much as its cost in interest—whether paid or foregone.

Other firms, contrariwise, given their plant scale and their particular differentiation characteristics, will find themselves unable to secure enough attached customers to sell at normal prices and earn normal profits. The end result is essentially the same here as under perfect identical product competition—exit of such firms. In a real sense, however, perfect differentiated competition is a harsher regimen than perfect identical product competition, because in adidtion to the necessity of maintaining production efficiency—lack of which alone can destroy the classical competitor when his industry is healthy—the differentiated competitor must also exercise good judgment in dealing with the uncertainties of pricing and of choice of optimal differentiation.

A major pricing problem confronting the differentiated competitor involves his determination of the normal amount of fluctuation in sales about his minimum cost level to be expected. If sales are more than normally stable, the firm's costs will be less than otherwise, so that at a given price the firm will earn more than normal return. Can such higher earnings be maintained, or will the firm's superior efficiency only prove to have been an illusion, blasted away by market invasion of profithungry rivals? Given a price which over time sustains reasonable earnings at output rates in its minimum cost region, the firm will tend to stick to it until costs in the industry change or until its short run demand changes clearly for the worse.

Analysis of the behavior of administered prices indicates that different behavior is to be expected for different circumstances. Thus, we may be dealing with cases in which the increase or decrease in demand or in costs applies generally through the industry, but not to the economy as a whole; we may be concerned only with how the individual administered price setter will behave when the changes which affect his costs or sales apply only to his firm rather than to his rivals.

There are clearly many possible cases deserving analysis, in each of which the characteristic behavior of prices and output would be different. But our concern here lies mainly in the general case, where the change in costs or demand affecting a firm applies generally to its industry. Unless otherwise indicated, the argument will rest on the assumption that the outlook for the economy as a whole is favorable—the case in which entry is most likely, other things equal.

*Response to demand changes*

Under the pricing policies just described, the firm would not respond to demand shifts with price changes unless these shifts were relatively large. If the price appears right but sales nevertheless fall, the firm will strive to shift its shortrun demand schedule back by improving its product package. If demand should increase, the firm has several choices of action, of which a price increase may seem the most dangerous.

The administered or entry limiting price yields normal profits for the differentiated competitor only at or about a given level of sales, making allowance for what extra costs are created by the temporary sales variations normal in the given market. Thus, the entry-limiting price is based on a markup over the costs incurred at optimum rates of production, a pricing device well known in industry as standard costing.

*Response to a general decline in industry demand*

As the sales of individual firms fall, along with industry demand, unit costs rise, since production is no longer at the optimal rate. The problem of whether to cut price can pose miserable dilemmas to the differentiated producer: in some competitive industries in which style is the key element in differentiation, it may often happen that a price reduction by a producer will be regarded as a tipoff by distributors of nonacceptance of his styles by consumers; again, price cuts may set up expectations of more cuts to follow, hence reducing demand even more in consequence. Weaker firms eventually must find themselves in a position where their short-run price is less than the limit price, so that it may appear that they will lose less in selling at a lower price than at the limit price. While this is happening, the sales of firms at the (higher) limit prices continue falling due to the decline in industry demand, and when the short run ends, their sales are then heavily eroded by the price cutters. If the decline goes far enough, prices could reach the point where they just cover average variable costs, the price decline being stopped at that point by the rapid shutdown or exist of capacity from the industry.

It is impossible to specify in any realistic sense just how the prices and outputs would behave during the pulldown from the limit price. We can say, however, that should the lower industry demand level persist, so long as there is some demand, adjustment will entail the exist or shutting down of enough capacity to cause an increase in the volume of sales of the firms remaining in operation, to the point, finally, where normal profits may again be earned. During this process, each remaining firm will be able to increase its price as its short-run profit maximizing price rises, though only in a most tentative and cautious manner. As earnings approach the normal level again, fear of market erosion is likely to slow down and stop the increase of prices and a new equilibrium in industry prices, profits, and capacity will be established again.

*Response to demand increases*

Behavior as demand rises reverses that taken as demand falls. A general rise in industry demand, that shifts each firm's short-run demand schedule and increases sales, will not directly lead to a price increase. If the firm increases its prices, may not it stand to lose customers to more cautious price setters? Price increases which are too hasty may hurt the firm very much in the long run. But, as output rises, so must costs; as costs rise, profits fall and may even turn into losses if sales increase enough and price is not raised. This situation is sharply different from the behavior of price and output under perfect identical product competition. In the latter case, price will rise, perhaps very sharply, as demand increases and will not fall near the minimum average cost level until entry of new capacity has done its profit-reducing work.

As growing sales drive up his costs, the differentiated competitor is in a most difficult position. He must gage the possibility that an increase in his price will lead to erosion of his demand; thus he must try to figure out how his rivals will react to his price increase. If he loses some customers, can he expect to get them back later? One key factor here turns on whether or not any of his competitors till possess excess capacity which they could and would use to bid away his customers. Since the rate of sales growth among the firms will not usually be identical, in the early stages of rising industry demand there will typically be enough unused capacity among competing firms to restrain price increases by those with faster rising sales.

The wall must break down eventually, however, for increasing sales for the firms mean ever higher costs, until and unless capacity is increased by the existing firms. This puts great pressure on the individual firms to raise price and, eventually—though this process is as obscure as what happens when demand falls—prices must rise if adequate entry of new capacity has not yet taken place. The differentiated firm which is established prior to a general demand increase thus will be hard put to get much profit advantage out of the favorable demand situation. This case is very unlike that of perfect identical competition, where the existing firms earn unusual profits until entry reduces prices down to equilibrium again. An alternative policy, of course, is for differentiated product firms in this position to hold down output and ration it among their customers.

Prices will only be raised when the firm finally decides that the present value of the probable losses expected in its future income is exceeded by the value of the expected gain in purely short-run earnings. The more speedy the entry of new capacity and the more possible it is for individual firms to raise their capacity without finding their minimum unit costs raised, the more pressure there will be against price increases. If the entry of new capacity is relatively slow and/or if growth in the average size of the firm is restricted by diseconomies of scale, the pressures against price rises will be reduced.

On the other hand, if the demand increase is not expected to last, resistance to price increases, plant expansion and rationing will probably be strengthened. Whether or not new capacity enters, the firm which anticipates a speedy return to normalcy may be willing to sacrifice some present earnings and may even stand for some losses as an investment in future sales and earnings.

Taking into account the many other less systematic factors which we cited earlier as bearing on price flexibility, it may well be that administered pricing may typically be more flexible than this argument has indicated. But it seems clear that—even under rigorously competitive conditions involving large numbers of competitors, who tend to earn only normal profits—pricing under product differentiation must be much less flexible than under perfect identical competition. The behavior of pricing in such strongholds of intensely competitive differentiation as the costume jewelry, garment, book publishing, and textile trades well fits this conclusion.

*Responses to cost changes*

Generalized cost changes have somewhat different pricing effects than those of demand movements. If the overall level of industry demand remains fixed, the results of cost increases must include a squeezing out of some industry capacity. Exit of some firms presupposes some bouncing around of sales rates among the firms, but the pressure of losses will amëliorate the situation by holding back entry of new capacity while it also is applying the final coup de grace to firms which were just hanging on before the cost increase took place. Thus, it is reasonable to expect that exit may be speedier when costs rise than entry is when demand rises. As exit takes place, sales per firm will rise. Again, resistance to prices increases would occur, but eventually some pattern of cautious, erratic sequences of price increases should develop until a new equilibrium in industry price and output is once more established. In this case, though, price should rise to its normal profits destination more quickly than in the case of demand increase. However, this gradual rise would only take place after exit of capacity has begun. Under identical product competition, price would sharply rise at once and then would slowly rise further toward equilibrium in profit-output rates as exit took place.

Should both demand and costs rise, essentially in step, the limit price increase should occur more quickly. How quickly prices would rise, however, would depend upon the degree of awareness among the firms as to the generality of their individual situations. In the limit, the price responses could be almost as fast as under classical competition, since no unsettling sloughing off of capacity would be required.

Decline in industry costs, with industry demand fixed, would also be reflected in price decline more quickly than in the case of demand decline. Awareness among firms used to earning normal profits that earnings were generally rising would suggest the entry of new capacity which could erode their markets; also, falling costs would make it possible for some of the weaker firms to pick up some extra sales by invading other firms' markets with small price cuts. The process of price reduction would not be so quickly discouraged by rising unit costs as in the case of falling demand, since the cost drop would increase the slack to be taken up. But output increasse would increase costs, discouraging output increases beyond some point. Entry of new capacity might be required to bring price down to the equilibrium level. This case is very similar to that of perfect identical competition though output could be expected to increase faster than in the latter case.

Where entry is not blocked for any existing or potential entrant who knows what he wants to produce, but knowledge of market trends is highly imperfect, the situation can be somewhat different than we have thus far argued: Assume that prospective entrants have adequate knowledge of prices and costs of particular types of differentiation, but not sales rates or profits. Under these circumstances, typical in a number of industries, the appropriate entry-limiting pricing strategy could well be the rule of applying a fixed margin to variable costs estimated for some standard output rate. Where such rules apply, pricing responses to cost changes would be virtually instantaneous, though responses to demand changes would probably be as slow as in the case of "perfect" differentiated competition.

*Some implications of perfectly competitive administered pricing*

The major implication in pricing behavior under conditions of perfect differentiated competition in respect to demand or cost changes is that such changes, in either direction, affect prices to a smaller extent, both in speed and in range of response, than would be the case under perfect identical competition. In general, pricing responses to cost changes could be expected to be much quicker than responses to demand changes. But if the new demand or cost situation persists, such competitive administered price industries will eventually get to an output and price position similar to that of perfect competition. Indeed, though the price responses, while capacity is fixed, are much slower than in the perfectly competitive "auction" price markets, there is no reason to assume entry or exit to be slower. Hence, perfect differentiated competition could well attain final equilibrium after a change in demand or costs as quickly as in the case of identical product competition.

The other side of the coin is the fact that slower price responses mean greater output fluctuations. Pricing behavior under inflationary conditions will thus be such that general cost increases will be rather quickly translated into price increases of similar magnitude. Except where demand increases are accompanied by similarly rising costs, however, their effects will primarily, though not exclusively, be in the form of increases in output from existing plant and entry of new capacty. These output increases, in a full employment economy (or, waiving this assumption, in a situation in which resources are not highly mobile) will result in rising factor costs. Thus, the upward price pressure of cost increases due to excessive output in relation to the most efficient scale will be buttressed by those added by increasing prices of the production factors. Thus, although via a somewhat different mechanism than that of identical product competition, prices under perfect differentiated competition will tend to rise following demand increases. In the long run, for a given increase in demand, the results under both types of competition will tend to be the same.

Rising demand levels in the economy, shared by an industry with perfect competitive differentiation, will thus result in higher prices in the industry. Limit pricing provides some slack before prices rise, but sustained increases in sales must drive up prices if entry doesn't catch up quickly. But even if entry is speedy, the pressures put by the increasing output rates on factor prices must drive prices up relatively quickly. The major difference between the two pricing situations is in the paths taken by intermediate output and price positions.

Administered pricing under perfect competitive differentiation places some drag on the rate of increase in the price indexes when demand or costs are rising, but it does not in any sense reduce, or even mitigate, the more fundamental inflationary impulses.

## ADMINISTERED PRICING WITH MARKET POWER

"Market power" may be defined as the degree of ability on the part of the firm to maintain its price at a level above that at which an entrant operating at average efficiency could make normal profits if he encountered no abnormal "organizational" expenses or risks in getting established.[4] The greater the investment required by existing or new firms in order to break into an established firm's market, the greater the return on "goodwill" which the entrant would have to earn in order to obtain normal profits on his total entry investment.

*Types of entry barriers*

Market power depends on the strength of the factors which deter entry from eroding away persistently large rates of profit in the hands of its possessor. Barriers to entry fall essentially into eight general categories:

(1) "Goodwill"—the exclusiveness of the firm's product differentiation and the expected costs of overcoming sufficiently for successful entry the market-attaching devices by which it is preserved by the firm.

[4] To avoid defining away "market power," since "normal profits" generally include returns to the risks and all organizational expenses of entry, we here define "normal profits" to include only a compensation for the risks of a going, established business plus a return in (riskless) interest. The extra returns required to justify entry against an entrenched rival, reflected in price, thus define the extent of "market power."

(2) The capital requirements for successful entry, together with the degree of specialization of these capital resources; the relation of the entering output scale to the size of the market, the rate of utilization of existing capacity and the growth trends in the market.

(3) Those created by preemption of vital scarce resources, locations or know-how.

(4) Those created by Government—as by licensing rules, patent and trademarks, procurement activities and subsidies.

(5) Those which, however market power was initially obtained, depend upon systematic competitive abuses.

(6) The existence of increasing economies as scale of output by the firm increases.

(7) The degree to which existing or potential rivals have reliable information about the circumstances and behavior record of the firm.

(8) The probability that entry would result in a price war and the probability that a prospective entrant could survive such a war. It may be noted that these probabilities can be substantially affected by the climate of antitrust enforcement.

The pricing objectives of firms with market power are assumed to focus on the aim of earning the highest returns possible in the short run which are consistent with longrun profit maximization. Circumstances may favor either one of the two possible pricing strategies: shortrun or longrun profit maximization.

*Shortrun profit maximization—The monopoly case*

The shortrun profit maximization potentialities of the firm may be of such size and expected duration as to overshadow any adverse longrun effects on the future earning stream. This will be the more likely as future market trends and developments are the less predictable and as the entry timelag is the greater. Market power exercised so as to produce shortrun profit maximization, however, will resemble the textbook monopoly case, rather than that of administered pricing. We, thus, distinguish "market power" from "monopoly" on the basis of the relevance of the entry deterrent. Monopoly circumstances and shortrun profit maximizing behavior should produce pricing flexibility comparable to that of the most competitive identical product industries.[5] One would not expect to find more than a few, if any, examples of such circumstances in the real world. This situation can be defined in administered pricing terminology as one in which the limit price, beyond which the firm would not go under any shortrun conditions, lies above the shortrun profit maximization price.

## LONGRUN PRICING UNDER MARKET POWER

Where firms possess market power, they typically follow administered pricing practices in which longrun considerations dominate shortrun price decisions. This case differs very little in a formal sense, therefore, from that of perfect differentiated competition. The key difference here, of course, is that pricing strategy allows the firm to price so as to earn more than normal profits—for simplicity, let us assume that the firm's operating efficiency is comparable to that of a probable entrant. The excess of profits over the normal level depends on the degree of market power possessed.

As in the case of the firm under competitive differentiation, the possessor of market power will determine a limit price calculated to maximize the firm's present value. This means that price will be set as high as it is judged it can safely be put without adversely affecting the future market. The limit price will be based on the highest safe return the firm can expect to earn when operating at maximum efficiency.

Thus, if the firm, regardless of how great its market power may be, is really out to earn as large profits as possible, the firm will price so high that it is at the edge of its safety margin or entry barrier. To be sure, firms with market power may play it extra safe by keeping price well below the level that maximizes longrun profits. Such a tranquilizer does not hurt the customer. Where firms, however powerful, overestimate their market power, entry acts to discipline them and reduce the general level of market power in the industry. The

[5] The monopoly case is, therefore, altogether different from that of administered pricing and none of the conclusions based on the logic of this pricing mechanism refer to such a case.

possessor of market power, thus, will aim at producing the output demanded over time by his market at the minimum possible costs for each output.[6] A qualification of this is required however: Partly as an entry barrier and partly in order to satisfy unexpected increases in demand without incurring excessive costs, the firm with market power will tend to carry some excess capacity. This excess capacity would raise both costs and price when demand is stationary, but could well lead to as low or lower average costs of a growing output over time than would occur if the firm adopted a more conservative capital investment policy. It is evident that such pressures toward capital investment based on future expected levels of demand will generate faster growth and capacity than would occur under more competitive conditions in which capital investment, normally, is more related to the actual level of sales.[7]

Among the additional considerations which will influence such a firm's estimate of its entry barrier and safe limit price level are the following: The degree of threat of market invasion by existing producers of competing near or far substitutes; the firm's expectations as to the degree to which high prices might stimulate product and technological innovations, which might crack open the entry barrier; the length of the short run; cyclical developments and expectational shifts which may affect expectations held by prospective entrants.

*Response to demand increases*

When demand increases, whether the firm will increase its price depends on its estimate of the circumstances confronting its existing rivals and upon its current evaluation of the probable expectations of possible new entrants. If the increase in demand reflects a shift in buyer preferences at the expense of existing rivals, there may be an increased entry threat even at the existing price. The degree of capacity utilization by its rivals will thus be highly significant. If increasing demand is also being experienced by the rivals, this deterrent to price increase will be relaxed.

It is interesting to note that the circumstances which influence the entry threat from existing rivals work oppositely in regard to prospective new entrants. A general increase in demand is favorable to the expectations of new entrants and increases the entry threat from this direction; a shift in demand to the firm from its rivals usually will have less threatening implications of new entry than of entry by existing rivals.

Whether its demand increase is reflected in similar increases for its rivals or not, the optimal strategy could well be for the firm to hold off on any price increase, while building additional capacity as quickly as possible. Thanks to the likelihood that the firm will have some excess capacity on hand and, also, to the fact that the relatively wide spread between price and average variable cost will typically imply that substantial output increases can be made without incurring losses, the firm with market power will be able to hold the price line for considerably greater sales increases than could be done by more competitive administered prices. Thus, price rigidity for demand increases can be expected to grow with market power.

*Response to decreasing demand*

If the demand decline in the industry is general, the threat of entry by existing rivals is greater, but that from new entrants is much reduced. Thus, if the short run is substantial in length, the firm may find no reason to reduce price, unless its own demand falls so far that its shortrun price drops below its limit price. At this point, competitive price cutting may take place, though slowed down by the shortrun lag effects.

As in the competitive case, it is difficult to specify the probable sequence of price and output changes following the onset of price reductions. So long as shortrun price is above the limit price for the given firm and its rivals, there would be great resistance to price cuts on the part of all. The only gains in profits possible from such price cuts would have to come from the increased sales due to market invasions, which would breed retaliation and increase uncertainty. Under these circumstances, upgrading of the "product package" might be an alternative approach involving fewer dangers of cutthroat competition.

[6] The conclusion that the holder of market power will aim at minimum average costs rests on the assumption that market-power profits are capitalized into rents and included in average costs. Optimum production thus takes place where price and incremental costs are equal.

[7] On the other hand, the accelerator implied by this market-power policy might be more conducive to cyclical instability than one related more to actual levels of sales achieved.

If the firm's demand decrease is not matched by declines in its rivals' sales, there may be little incentive to lower price for shortrun reasons, until the decline in demand brings shortrun price below the limit price. Whether it would be worthwhile to reduce price so as to invade the markets of rivals would depend on many factors implicit in assessment of the possible gains of successful invasion along with the probabilities and dangers of retaliation and increased uncertainty.

While deterioration in the market share of a firm with market power will typically induce some defensive responses, these responses may well take the form more of increased selling efforts and greater attention to product quality improvements than of changes in price. It is highly unlikely, in any event, that price reductions would be made very quickly.

*Response to cost increases*

If cost increases which affect the firm are also assumed to affect its rivals, and to substantially the same extent, and if the same cost effects would apply to prospective new entrants, the entry barrier is, in effect, lowered. If the previous price structure and the market shares among the rivals were reasonably stable, price might well be raised on the reasonable expectation that the rivals would follow. This would not hold so clearly to the extent that there were any significant tendency for rival firms to engage in market invasion by means of price competition. But in a well-established industry, any pronounced tendencies toward market invasion imply excessive prices, since limit prices are set with the purpose of minimizing all such dangers. If the markups implicit in the limit prices were reasonable prior to the cost increases, and if at the same time no other destabilizing developments occurred, the cost increases should rather quickly be reflected in increased prices.

Cost increases to one firm which were not experienced by rivals or applicable to new entrants would mean a decline in its market power. Under these circumstances, there would be little tendency for the rational firm to raise its price, however much it might like to do so.

*Response to cost decreases*

If cost decreases are general, they imply a reduction in entry barriers, unless they are translated into low limit prices. Cost declines pertaining only to one firm, if they are due to factor price circumstances peculiar to the one firm and thus unavailable to rivals or new entrants, would amount to corresponding increases in market power and would not necessarily call for any reduction in the limit price. Relative gains in efficiency by the firm, leading to reduced costs not applicable to rivals or entrants would not lead necessarily to any drop in the limited price. But in a highly dynamic economy, in which technology is changing fast and production innovations with broad applications are developing too fast for any one company to keep up with them, most firms would take advantage of increased efficiency to pass on at least some of its benefits to the consumer. This would, of course, put pressure on existing rivals and reduce their market power.

Where a firm can improve its cost position vis-a-vis its competitors, actual or prospective, it may well proceed to increase its capacity and cut its price so as to invade the markets of rivals. Whether such a policy will be undertaken and what its chances of success might be depend on many imponderables. The crucial questions are whether a price war might break out and what the lasting consequences of that could be expected to be. Whether threats of such disciplinary actions by the higher cost producers are significant factors in actual situations and effective in preventing lower cost firms from fully exploiting their cost advantages is not easy to determine. A priori, a great number and variety of circumstances would condition the outcome. It is worthy of note, however, that business mores support price reductions based on cost advantages much more strongly than they do price cuts not so supported.

Where the threat of entry is a strong inhibitor of price increase and price war retaliations likewise inhibit price cuts, the limit price becomes both a ceiling and a floor. This, the typical case of oligopoly theory, carries to extremes the possible price inflexibility, while making it most difficult to specify any simple practical rationale to explain the processes of price adjustment. However, for such cases it would appear reasonable to predict far greater price flexibility for cost than demand changes. This thesis rests on the assumptions that the oligopolists have a mutual awareness of each other's interest in making money, a common concern regarding entry of new capacity and an unwillingness to indulge in cutthroat competition. This conclusion is quite opposite to that reached by the standard "kinky demand move" theory, in which prices are assumed to be highly inflexible regarding cost changes and in which incremental costs rather than minimum average costs are decisive.

CONCLUSIONS

*Administered pricing*

Our discussion of price responses to cost and demand change suggests that uncertainties bedevil the differentiated competitor at every turn of events. In the real world, dynamic changes are constantly at work, shifting demand relationships among industries and among the firms within them, while relative cost structures are being continually dislodged by technological changes and changing factor price structures.

Unless dramatic changes occur in the relative market position of the firm or in its earnings rate, the typical firm with market power may not often feel compelled to change the fixed markup from which its limit price is derived, particularly since such changes could mean possible market erosion by rivals, or price wars, etc. A pricing philosophy may become established in an industry reflecting a general consensus among the rivals as to what margins are reasonable. Such industrial mores or conventions would make possible greater pricing flexibility than could exist in its absence, however.

It may be taken for granted that cost increases should normally be rather quickly passed on in higher limit prices, preserving the entry limiting margin, but that demand increases would call for increased pricing caution. Cost declines unaccompanied by demand declines may result in relatively quick price responses to preserve margins when they are believed to imply greater entry threats, but if cost declines occur when industry or general demand is falling, they may be only slowly reflected in price cuts, since entry of new capacity would then be a mimimal threat. But dynamic economic changes are constantly working to break up such agreeable oases of economic decision making. New products, unexpected entry and changing preferences of consumers bring anxiety back into decisionmaking which, under some circumstances, acts to shake up price structures and, in other cases, makes them more rigid.

*The direct role of administered pricing in inflation*

In a period of high-level employment, it is doubtful whether, on balance, administered pricing adds or subtracts very much to the inflationary pressures. On the one hand, its essentially passive pricing responses to rising demand and costs act as retarding influences on the rise of the price level. But, on the other hand, this very retardation puts such additional pressures on output and investment that the induced price pressures on factor markets may well drive administered prices up by as much as the initial price rigidity tended to hold them down.

The picture is, or may be, different when inflationary pressures are operative while there is slack in relevant labor and other factor markets. In this case, demand increases may not affect factor prices very much, and output may rise without much in the way of price increases. Here, administered pricing behavior has more favorable price-level implications than classical competition. In general, however, there seems little reason either to praise or blame administered pricing for its direct role during an inflationary period. It seems clear that while administered pricing adds no steam to inflation, it likewse does little to cool it down.

*Administered pricing and resource allocation*

There is no apparent reason to indict administered pricing, in itself, for its longrun effects on economic growth. Its prices, to the extent that they rise more slowly in response to demand or cost increases than perfectly competitive prices, may more greatly stimulate output and capacity expansion. For the long pull, however, taking the whole economy into account, it is difficult in the extreme to assess the price-output-investment consequences of administered pricing.

It cannot be denied that administered pricing rigidity violates the marginal conditions by which economists evaluate economic performance. Rigidities in pricing, like other rigidities in the economic system, do prevent resources from being used with maximum effectiveness in the short run. The charge is a fair one, but the fault lies primarily with product differentiation. It just isn't remotely possible to have the one without the other. Since prices (or markups) can be, and undoubtedly are, as rigid or more so among corner grocery stores and in the competitive maelstrom of the costume jewelry industry as they are in the haunts of large-scale business, it would seem appropriate to concentrate attention more on defects of the economic system which can be improved by governmental action.

*The role of product differentiation*

As product differentiation replaces standardization, consumer and producer wants are met with greater selectivity—the buyers' choices are widened and more precisely satisfied. But this improvement in the want-satisfying characteristics of output represents a substitution of less output for more. This substitution, made freely by the consuming public, is undoubtedly associated with many of the same factors which are responsible for our fast-increasing substitution of services for physical output.

Very important, also, is the fact that differentiation increases business uncertainty, since the demand confronting the firm is typically less stable and dependable than is the demand for its industry. These uncertainties increase output fluctuation, which also increase the average level of production costs over time. Differentiation makes business more risky; production efficiency alone being less of a guarantee of success than it is under standardized product markets.

In consideration of the administered pricing it necessitates, as well as its adverse effects on resource mobility and its other costs, it cannot be doubted that prevaling trends in product differentiation are significantly influencing the performance of the economy. Since this trend is basically the result of consumer choices made under conditions of ever rising real incomes, it meets and satisfies the basic criterion that the purpose of privately directed production should be consumption. Since differentiation reduces the importance of large-scale production and opens many doors to imaginatively managed small business, this trend undoubtedly has also been a major factor in preserving the economy from any trend toward increasing economic concentration.

There are, thus, both good and bad things to say about differentiation. In a wealthy economy like ours, differentiation appears rooted too solidly in freely expressed preferences, of producers as well as consumers, for public policy to seriously question the case in its defense.

*The impact of market power on price flexibility*

In a general sense, the degree of market power could not be expected to have much influence on the end result of any change in demand or factor prices, so long as the relative structure of entry barriers remains intact. But some asymmetrics can be expected along the way.

Because the degree of market power affects the relative gap between the limit price and variable costs, a given fall in demand will tend to drive competitive firms toward price cuts more quickly than where market power is large.

On the downward side, therefore, prices should be more responsive to demand declines as competitiveness increases. But the opposite conclusion holds for cost declines. Here, entry of new capital is the important disciplinary force and the threat of this affects the more competitive firms much less than it does the less competitive.

On the up side, cost increases can be expected to be passed on much more quickly by the powerful than the weak, but the opposite is the case for demand increases.

Our analysis thus indicates that, under conditions similar to those of the relatively high employment stability which have characterized the post-World War II economy, the influence of market power on pricing flexibility is as follows: the sensitivity of prices to cost changes tends to be greater as market power is larger, while price responsiveness to demand shifts is greater as market power is smaller. Since both factors work during inflation and deflation, there seems little choice to be made on this account alone.

The problem of market power is a different one from that of administered pricing, per se. Regardless of what we do or don't do about market power, whether in business or in union hands, it can be said with authority that administered pricing and its relative inflexibilities are here to stay. So long as we all want diversity in products—differentiation—we will have administered pricing. And, though one would prefer to have the benefits of differentiation without paying for it with loss in price flexibility, it would hardly seem appropriate, as some have recommended, in the name of flexibility to replace "administered pricing" autonomy with price controls which would, by their nature, preclude almost all price flexibility.

Representative KILBURN. Mr. Gray is our next panelist.

## STATEMENT OF HORACE M. GRAY, PROFESSOR OF ECONOMICS, UNIVERSITY OF ILLINOIS

Mr. GRAY. I regret I didn't have time to get this statement mimeographed. But there are some typewritten copies available here.

Monopoly, in whatever form or degree, is a restrictive system of economic organization and, hence, is incompatible with the objectives of the Employment Act of 1946. A monopolist to achieve economic power to continue in possesison of it and to use it for the maximization of profit must practice restriction. He has no choice in the matter; he must either resort to restriction or cease to be a monopolist. The long and tortuous history of man's effort to create monopolies and to garner the fruits of monopoly power confirms this judgment.

In order to practice restriction the monopolist must have some significant, or decisive, degree of control over the basic elements in the economic process, such as natural resources, organization, technology, capital and credit, transportation, markets, and prices. Furthermore, in order to preserve his monopoly, he must have the power to restrain, suppress or exclude competition.

In a free society, however, such private economic power, standing alone, is inherently weak, limited and transient; it can never, by private effort alone, achieve complete power or insure survival.

Hence, to escape from this state of jeopardy and insecurity, private monopoly must seek the protection and support of government. This necessity to buttress its limited and precarious economic power with the sovereign political power of the national state results in the so-called unification of economic and political power.

What does the monopolist need and want from the political state? First, and from a negative point of view, he wants acceptance, acquiescence, toleration, forbearance, freedom of action, and nonintervention with respect to his aggressive, restrictive tactics. Such negativism on the part of government is essential for the exercise of private economic power, but it falls far short of being adequate to allay the monopolist's fears or serve his ambition.

His second demand, therefore, is for positive, affirmative state action to supplement private with public power. This involves such things as—

1. Legitimization
2. Suppression of competition
3. Restriction of entry
4. Exclusive grants of privilege
5. Protection against foreign competition
6. Sanction for monopoly prices
7. Guarantee of profits
8. Subsidies
9. Preferential taxation
10. Contributions of capital
11. Sharing of costs
12. Insurance against risks

Under this dispensation, Government becomes the guardian, protector, and partner of private monoply; it clothes monopoly with delegated powers of sovereignty; it undertakes to maintain private power at public expense—i.e., at the expense of consumers, taxpayers, workers, small businessmen, and other excluded or victimized groups. Government is no longer the servant of the people but rather the abject handmaiden of private monopoly.

Private monopoly, when thus fortified by public sanctions, is a powerful, two-edged sword which cuts in two directions. In the area of production it restricts output, investment, technological innovation, employment, and economic growth. In the area of distribution it erodes away mass purchasing power by excessive prices, deterioration of quality, limitation of service, and abnormal profits. The purchasing power thus diverted from the people into the coffers of monopoly is used not to increase production but to aggrandize private economic power.

During the past 20 years this organic, naturalistic pattern of monopolistic behavior has been obscured by vast military and defense expenditures, monetary inflation, foreign-aid giveaways, subsidization of private investment, inventory accumulation—both public and private—transfer payments, and subsidized technological development. Thus, despite monopoly and ever-increasing concentration, we have, by these artificial methods, maintained substantially full employment, promoted economic growth—albeit of a distorted character—and provided maximum purchasing power. On this record, then, it might be argued, with superficial plausibility, that the existing concentration of economic power has not operated, and will not in the future operate, to prevent substantial attainment of the objectives of the Employment Act of 1946. This essentially is the position of those who ignore the problem of economic structure in our society and advocate the continued utilization of artificial methods to insure full employment.

I cannot accept this view. Having studied the ways of monopoly for over 30 years, I am convinced that its restrictive motivation is antithetical to full use of resources. A purely private monopoly—a relatively rare phenomenon today—has only limited power to frustrate the attainment of welfare goals. When, however, most of our basic industries are controlled by a few giant corporations, which enjoy not only the tolerance of Government but its affirmative support and subsidization, the capacity of these great power groups to restrict production is a formidable obstacle to full production.

Artificial inducements, such as subsidy and continuous inflation, can only partially and for a brief time mitigate their natural propensity to practice restriction in the interest of profit maximization. In the long run these artificial devices fail to promote full production and employment, and only serve to enhance industrial concentration. No system of incentives, to my knowledge, has ever been devised to induce monopolists to behave contrary to their interest, motivation, and imperatives for survival.

The Congress, it seems to me, should recognize this basic inconsistency between monopoly power and the declared objectives of the Employment Act. It should no longer avoid this irrepressible conflict or seek to mitigate it by artificial devices of an inflationary character. The situation calls for a broad, sustained attack on the excessive concentration of economic power in our basic industries.

The goal should be to restore and revitalize competition wherever and to whatever extent it is technically possible to do so. Perfect competition, as in the classic model, is an unattainable and unrealistic ideal in the modern economy but it is possible to make the system far more competitive than it now is.

Constructive policies to promote competition and to lessen the impact of monopoly power will contribute significantly to realization of the social objectives of the Employment Act.

Representative KILBURN. Although Professor Kahn was unable to appear he has submitted the following for the record.

## STATEMENT OF ALFRED E. KAHN, PROFESSOR OF ECONOMICS, CORNELL UNIVERSITY

I should like to direct my remarks to the following question: To what extent can antitrust enforcement and related Government policies affecting the organization and functioning of individual industries and markets help maintain price stability in an expanding economy?

Diagnosis should precede prescription. Before discussing possible remedies it seems desirable to point out, therefore, that the more than doubling of consumer prices that has taken place since 1939 cannot be attributed primarily to wage or price policies, to the presence or absence of effective competition in labor or product markets. While the question of whether inflations essentially reflect the pull of demand or the push of quoted wages and prices is in some measure a chicken-and-the-egg proposition, most economists would surely agree that the main culprit in the last 20 years has been the sharp rises in aggregate spending during the 1939–48 and 1950–51 periods, during which most of the price increase was concentrated. To put it another way, inflation is not caused primarily by profiteering or monopoly.

The evidence since 1952 is still not clear to what extent labor or business monopoly poses a continuing threat of mounting prices. True, wholesale prices rose over 6 percent and the consumer price index over 5 percent between 1955 and 1957, while gross national product in real terms was increasing only by a very disappointing 3.6 percent; true, also, the cost of living went up another 2.6 percent during the recession, between July 1957 and November 1958. But 1956 and 1957 were years of unusually slow increase in man-hour productivity; they also witnessed a boom in business spending for plant and equipment, which produced an unusually rapid rise in the price of producers' durables but whose fruits in increased productivity are only now appearing. Recall also that the main components of the cost-of-living rise have been food and services, not unusually monopolistic segments of the economy.

Nevertheless, it is impossible to deny that private power over prices and wages may pose threats to price stability, and there is evidence—though I know of no systematic study of the subject and I am not sure the question can in any case be answered conclusively—that such power may have contributed to recent price increases while real national output stagnated. It was an unmistakable sign of monopoly power that the steel industry could raise prices in 1957, with operations slumping, and again in mid-1958 when it was working at less than 60 percent of capacity; it was equally a sign of monopoly power that the steelworkers' wages (and the industry's unit labor costs) could have been boosted in those circumstances—in the second instance with well over 100,000 steelworkers unemployed. The declining retail price of consumers durable goods between 1952 and 1956 was a reflection only of a one-shot squeezing of retail margins; wholesale prices rose steadily in the same period and since 1955 they—and automobiles in particular—have accounted for a significant part of increase in the cost of living. The ability of an industry that produced about 8 million cars in 1955 to raise its prices progressively since that time, while output has run between 50 and 75 percent of the peak level, is another sign, in my opinion, of ineffective price competition. The contrast between the behavior during the recent recession of the prices of aluminum and steel on the one hand and copper and zinc on the other, of crude oil on the one hand and of petroleum products on the other is simply inexplicable except in terms of the different degrees of market control over these groups of goods. I have no doubt either that some part of the rise in prices of services, which has played so important a role in boosting the cost of living, itself reflects wage and price administration, rather than the mere upward pull of demand.

Can the antitrust laws help us escape the dilemma of having to choose between economic growth and price stability? They do help; in their absence our markets, national and local, would in my opinion be markedly more concentrated, the prevalence and effectiveness of collusive or quasi-collusive price fixing greatly increased, and profit margins and therefore prices higher than they now are. Whether prices would also have a greater tendency than they now do, continuously to increase is much more difficult to demonstrate; but I believe reduced pressures of competition would mean reduced pressures to cut costs, to introduce new and competitive processes and products, and would therefore involve an altered trend as well as an altered level of prices. I have the strong impression, finally—though this too requires more intensive study—that the more intense is price competition in product markets, the more likely are businesses to resist the continuing upward pressures on wages and labor costs that must bear a heavy responsibility for any inherent tendencies of our economy to administered inflation. Conceivably however an industrywide union might succeed in pushing up wages even faster if it were free to deal with small individual employers separately.

Yet it also seems clear that the antitrust laws as presently constituted cannot and do not eliminate the threat of administered wage-price inflation. They do not apply to union influences on wages. And they are powerless to prevent the process whereby concentrated industries agree first to pay higher wages, and then, without evidence or indeed need for collusion, use the occasion to raise selling prices. The law cannot handle noncollusive oligopoly pricing.

The recommendations in the President's Economic Report with respect to strengthening the antitrust laws would of course not remedy these deficiencies. Though they strike me as desirable, they are essentially peripheral in nature. They should help prevent deterioration of competition, but they provide no such dramatic new weapon as would be required to meet the problem here under scrutiny.

The law could, of course, be reframed so as to attack and dissolve the power of unions over wages, and the power of noncollusive oligopoly over prices. But I am frankly uncertain that either the efficacy of the need—in terms of moderating inflation—can be demonstrated. If the problem of administered inflation does prove to be more serious than is now evident, it might be more promising to take such steps as to prohibit price increases in concentrated industries within, say, 6 months of the negotiation of new wage agreements that raise wages (including fringe benefits) by more than, say, 3 percent a year, than to take the antitrust route. I believe it is a mistake to try to impose on antitrust more than it is equipped to accomplish.

However, there are numerous steps, far more clearly compatible with private enterprise than those suggested so far, that the Government can and should take. While this committee is giving serious attention to the problem of price increases, the Office of Defense Mobilization is moving, according to the newspapers, to tighten the limitations on the importation of crude oil and its products. I am not an expert on the national defense, but I am a student of the petroleum industry; and I have yet to find a consistent, rational explanation of the particular price-increasing policies that surround this industry in terms either of national defense or of conservation. I find it difficult to understand why our defense requires the limitation of imports from Canada, for example; or why military requirements generally stated in terms of a million barrels a day of shut-in capacity have anything to do with justifying the roughly 3 million barrels shut-in during 1958—a figure undoubtedly exceeded in the several months when production in Texas was cut back to 8 days. Nor do I see why American taxpayers should forgo taxes on the foreign operations of American oil companies while domestic consumers are carefully insulated from the possible advantages of the cheap oil developed and produced under stimulus of those tax inducements.

There is time only to mention a few other possibilities: (1) It is notorious that our stockpiling policy is used as much to support prices as to meet specific military goals. (2) The particular method we have chosen to assist agriculture is the method that above all alternatives raises prices, and in so doing incidentally helps most the farmers who need help least. (3) It is anomalous, too, to retain even a modest tariff on the foreign automobiles that, along with American Motors and Studebaker-Packard, are the only source of effective price competition in that industry. It would probably be helpful to break up General Motors, but it would be less necessary if the duties were eliminated. (4) Finally, to take quite a different example, it might help hold down the cost of living if the Federal Power Commission showed some sign of moving toward effective regulation of the field price of natural gas, now 4½ years since the Phillips decision.

These proposals are suggestive only, and necessarily inadequately documented in this brief statement. But they suggest that, among policies affecting business structure and pricing, antitrust is not the only weapon the Government has with which to deal with the phenomenon of administered inflation.

Representative KILBURN. Next on our panel is Mr. Mark S. Massel, senior staff member, the Brookings Institution.

## STATEMENT OF MARK S. MASSEL, SENIOR STAFF MEMBER, THE BROOKINGS INSTITUTION

Mr. MASSEL. The major question the committee has asked of the panel relates to the contribution of our current antitrust policy to the attainment of the Employment Act's objective of economic growth and stability.

It seems to me that there is little doubt about the answer to the question about the contribution that competition makes to economic growth. For the answer we do not have to depend entirely on the observations of our own economists. We find an interesting answer in several reports which have been made by productivity teams which have come over from England as part of the Anglo-American productivity program.

Teams that came over to study industrial engineering, accounting, and the steel foundry industry were all convinced that one of the basic reasons for the high level of productivity and the high rate of growth in the United States is the strength of our competition.

These were business groups, not academic economists. Among their major recommendations in England was the suggestion that it would be highly desirable to adopt a competitive program.

When we turn, however, to the question of the influence of competition on stability, it seems to me that the answer is not clear.

For such an answer we need, among other elements regarding inflation and business fluctuations, much more research regarding the nature of competition, how it is operating, and what its influences may be on stability. At the same time, we need a basic review of governmental policy in the area of competition and in the enforcement of the antitrust laws.

Let us look, first, at one of the foundation problems in analyzing the structure of competition. Before we can get many answers to the questions raised by the panel we must have a better understanding about the nature of costs, the structure of costs and price behavior.

In this consideration we must bear in mind the double influence of costs. On the one hand, they are the direct element in the individual company's decisions about prices. On the other hand, costs represent purchasing power in the hands of the recipients of the money payments. Therefore, the cost structures influence prices because of their effect on the nature and the size of the total demand.

Over the last several decades—certainly since the turn of the century—there have been substantial changes in our cost structures. There have been many forces driving for more regularity in costs and less flexibility in business cost responses to changes in volume.

Progress in mechanization has increased longer run costs, such as depreciation, which do not react to changes in volume. We have seen tremendous increases in factory overheads and in longrun distributive overheads. Research and development costs, which do not fluctuate with changes in volume, have become much more significant.

Partly because of the increased training needs for workers and partly because of a sustained period of high employment when efficient workers were hard to find, there is less flexibility in the employment of individual plants than there previously has been. Many companies feel that the costs of hiring and firing, including the costs of training, the cost of social security, and other longrun problems, make it more desirable to maintain more stability in the labor force. Therefore, they do not reduce their labor forces as readily as they formerly did when production went down, nor increase their labor forces when production increased. Hence, the total amount of employment is not nearly as responsive to total production as it had been. These factors have made costs less adjustable to volume and have helped to sustain purchasing power during low-volume periods.

At the same time, skilled and technical labor finds it desirable to exercise less mobility. The positions of skilled and technical workers are more stable. At the same time, these workers are tied to the job more closely because of corporate pension plans which do not provide for vesting.

We have seen some dramatic signs of this change in the nature of competition in several points made in the President's Economic Report. It is pointed out, for example, that for every decline of $1 billion in private output, personal income earned fell $360 million in 1957–58, contrasted with a drop of $670 million in the period 1929–30.

In other words, personal income was much more stable relative to volume than it had been. This came about, in good part, because of governmental operations, including various transfer payments. However, this result was influenced also by the greater stability in employment than we had 30 years ago.

Similarly, the Economic Report points out that for every decline of $1 billion in gross national product, retained earnings and corporate income taxes dropped much more violently in the period 1957–58 than they had in the period 1929–30.

These changes in the structure of costs and the accompanying changes in the structure of demand indicate the need for a new look at the nature of competition and what we can expect to see in its future influence on stability.

Turning to antitrust policy, it seems to me that we require a broader approach in reexamining the influence of the antitrust laws on general competitive conditions as well as the effectiveness of enforcement of these laws.

The first question is whether enforcement is concentrated on those markets and industries which require attention. Our antitrust agencies act almost entirely in response to complaints from industry. Therefore, we should consider the need for examining the total economy to see those areas in which more antitrust enforcement is needed instead of relying on complaints.

The second question is whether some of our antitrust laws, themselves, may act to develop price rigidities and lessen competition. For example, there are signs that the enforcement of the Robinson-Patman Act has promoted price rigidity. In that event, the remaining competition may not contribute to stability in the sense in which some economic theory holds it should.

Third, we need to analyze the effects of the court decrees after antitrust prosecutions. We do not know today whether or not these decrees help to maintain or restore competition.

Incidentally, examining the effects of decrees has become extremely difficult because of the current practice of relying mainly on antitrust consent decrees. Thus, over the last 5 years, 88 percent of the antitrust decrees developed by the Antitrust Division have been consent decrees. Under the consent decree procedure, there is no public record of the seriousness of the practice under attack or its effects. The decree is negotiated between the lawyers for the Antitrust Division and the lawyers for the defendant. With this procedure it has been difficult for Congress and the public to evaluate the influence of our antitrust work. We greatly need, it seems to me, to develop a practical method of exploring the effects of the enforcement of the antitrust laws themeselves.

We should also examine the effect on competition of other regulatory laws of the Government if we are to consider our competitive policies. The questions placed before the panel may be taken to imply that all Government actions are consistent with our antitrust policy. However, even a cursory examination of the range of governmental regulation, on the Federal, State, and local levels, indicates that we have developed a body of law which clearly prevents competition. And we seem to be dedicated to passing more laws of the same type.

To take a few examples, we have protective tariffs and quotas to keep out foreign competition. We have tax rules which favor acquisitions and which make it expensive for companies to spin off parts of their operations. We encourage resale price maintenance. We have the Robinson-Patman Act provision which almost requires payments of brokerage.

Our regulation of railroad and truck rates promotes further price rigidities which ignore competitive forces. We have limited entry into the communications and transportation fields through the activities of our regulatory agencies.

On the State level, we have a veritable host of regulations which dull the edge of competition and may even eliminate it. To list a few examples, we have fair trade, regulations providing for minimum markups, licensing regulations preventing entry into business, milkshed regulation which restrains competition, gasoline and liquor price regulation, limitations on the production of petroleum, building codes which restrict competitive practices, and a host of other regulations which are dedicated to preventing and avoiding competition.

Further, in examining our current antitrust policy, I suggest that the committee turn its attention to the affirmative uses of other governmental nonregulatory activities to encourage competition.

Consider, for example, what the Government can do through its own purchasing activities and its experimental and developmental work in order to encourage companies to enter into new industries and to keep small business in the competitive swim.

If the committee plans to explore the effects of competition and our antitrust laws on growth and stability, I should like to suggest that it give serious consideration to an extended, broad examination of the structure of competition, the enforcement and effects of our antitrust laws, Federal, State, and local restrictions on competition, and the affirmative uses of nonregulatory activities of Government to stimulate and guide competition.

Representative KILBURN. Thank you very much, Mr. Massel.

I am sorry to say that I am neither a lawyer nor an economist. But one thing I would like to inquire from Mr. Frucht is: Just what do you mean by administered pricing?

Mr. FRUCHT. An administered price is a price which is set by the firm and does not immediately respond to every change in its costs or in its sales or immediate market position.

Representative KILBURN. You mean prices administered by the firm?

Mr. FRUCHT. That is right.

Such administration of prices is found in some of the most competitive industries, such as the costume jewelry industry or the garment industry. These are actively competitive industries, but we, nevertheless, find administered pricing in them. Firms with differentiated products must assess the longer-run effects on their sales of price changes and do not immediately react to changes in their demand or to changes in their cost until they have looked around enough to determine that pricing adjustments will not worsen their market situations. For instance, suppose we have an industry like the garment trades, and the cost of materials goes way up; do we get in such an industry an immediate reflection of that materials, cost increase in price?

No, sir. This won't happen immediately, because if I raise and you don't, you may take my customers away from me.

Firms under such circumstances may take a beating if prices and sales are continually fluctuating about. Each such firm must worry about what happens to its customers as a result of its short-run pricing. Where you have a situation where the firm has to take account of the effect of its pricing today on its market tomorrow, then you get administered prices and some relative degree of price inflexibility.

Representative KILBURN. Conversely, suppose the prices may be too high and his competitor cuts his price on the market tomorrow. He has to cut his price.

Mr. FRUCHT. No; I wouldn't say so. I would say again that there would be resistance on this side, whether we are dealing with drugstores or giant corporations. There would be resistance to lowering price when demand declines and resistance to bringing price down in the case of cost declines. The amount of resistance will depend, however, on the degree of market power, on the nature of the markup that the firms charge and on the degree to which the circumstances tend to increase or decrease the threat of potential entry.

If I have a very high markup so that my sales can fall considerably and leave me still in the black, I am under less pressure to reduce my price than if my markup is very slight and a little cut in my sales rate will drive up my costs so as to cancel out my profits.

These factors work differently on the upside and on the downside. They work differently as the industry as a whole is or is not involved in the change; whether the industry demand and/or its costs are similarly affected, or whether the change only applies to one firm.

All I am saying is that differentiation, the very fact of differentiation, introduces rigidities into pricing; and that these rigidities have consequences for the behavior of the price level in a general sense, although their extent depends on a number of particular circumstances, which my longer statement will attempt to develop.

Mr. BARKIN. Mr. Kilburn, since you are interested, may I make this just a little more specific. If you buy a shirt and that shirt is going to be \$3.99, the retail price will stay at \$3.99. Whether the costs move up or not, it stays at that price.

Now——

Representative KILBURN. Well, supposing your competitor is able to cut his cost and sells it for $3.50.

Mr. BARKIN. Well, he isn't likely to, because the traditions of the retail industry are such that what is known as the "price line" exists. You just don't sell anything for $3.75; you only sell at $3.99 or $3.49. And within those spans there is very little flexibility.

Now what often happens in these circumstances is that you might get a better shirt for $3.99 if the costs of the cloth have dropped. On the other hand if the price of the cloth has risen, you might get less trimming on that shirt.

Now this is one illustration; but obviously this is in an area of real competition. On the other hand, the public debate really doesn't focus on these industries which technically reflect price administration. But what we are most concerned about, and what the public debate is really centered on is the areas where there is outright administration by large corporations in terms of their own concepts of return and their own concepts of market where there are no such technical inhibitions in movement, such as steel, aluminum, and others.

Representative KILBURN. I have just a couple of questions here.

Mr. Barkin, what do you mean by "an important step toward such action would be Federal incorporation"?

Mr. BARKIN. Well, Senator O'Mahoney, back in the TNEC days, submitted a bill on which congressional hearings were held requiring the Federal incorporation of certain specified and defined business organizations in the United States which would require them to have a Federal charter for operation in place of their present State charters.

Representative KILBURN. One other question.

Mr. Gray, as I got the tenor of your statement, I had supposed in my naive way that the only monopolies in this country were the public utilities which of course are regulated by the public service commission and other laws.

For example, do you consider the electrical manufacturers, General Electric and Westinghouse—do you think those are monopolies?

Mr. GRAY. Perhaps I had best explain my usage. I am using the term "monopoly" here in a generic sense of market control. And I stated in the very first sentence that I am concerned with market control of whatever degree and whatever form it may take.

Now, the example you mentioned of utilities, that is a legalized monopoly. That is one form. But we have many forms of monopoly.

If you concern yourself with the degree, in every instance there is some significant control over certain of the basic factors in the economic process. I am using it in a general sense.

Now, you can multiply terms; you can talk about monopoly, duopoly and oligopoly, and clear on down to monopolistic competition. These are shades of some significant degree of market control.

And I use the general term to describe a whole range of situations where the degree of control and the form that it takes and the way it manifests itself may vary greatly. It is a general usage of the term.

Representative KILBURN. I had supposed that General Electric and Westinghouse, for example, would competitively speaking like to cut each other's throat.

Mr. GRAY. Most economists would refer to that as an oligopolistic situation. When a few large concerns dominate an industry. Oligopoly is the term used when you are dealing with a "big two," "big three," or "big four," or "big five" that dominate an industry.

Mr. BARKIN. Congressman, aren't they after each other's throat but hardly bringing any greater solace to the consumer?

Representative KILBURN. If they run their company just as efficiently as they can and cut their costs as much as they can in order to get the business, why, I should think the consumer would benefit by that.

Mr. BARKIN. Apparently it doesn't get reflected in prices. That is the consumer's way of getting it. They may be more and more efficient, but we haven't seen it in prices.

Representative KILBURN. Well, of course, the gage on it is the profit.

Mr. BARKIN. I think their profit margins have reflected the fact that they haven't passed it on to the consumer.

Representative KILBURN. Well, some years they have big profits and some years they have lower profits.

I don't know anything about it. I have no connection with it at all. But——

Mr. GRAY. I think we ought not to call it competition at all. We don't have a good term to describe this situation. A businessman tends to think of competition in this sense; but the economists recognize that it isn't competition.

I frequently use the term "corporate rivalry" to describe the struggle between two or three giant corporations for strategic control of the market and the factors of production. It is a kind of "corporate rivalry"—not really competition in the traditional sense of the word. Although in popular discussion we call this competition, this usage is derived from the business world rather than from traditional economics.

Representative KILBURN. Of course, it seems, just thinking out loud, that things such as practice of 50, 60, or 75 years ago of the then Standard Oil Co. in giving concessions on freight rates and the like should be regulated. But you take a case like that of Henry Ford who built up the assembly line technique and cut his costs to beat the band and cut his price to the consumer, and got very wealthy in the process. I think that was fine. He was doing a service to the community, to the consumer. So that if you have got things that aren't fair to the consumer, then the Government ought to step in.

But where you have got somebody that is smart enough to go along on the free competitive enterprise system in this country, I think it should be encouraged.

Mr. GRAY. My theory is we ought to make the system more competitive than it now is. Any additional competition we can inject into the system would be good for the society. I think we could do a lot more than we do.

Representative KILBURN. One other question for Mr. Barkin. You speak about the tax advantage that a good company takes over by buying out a company which has accumulated a tax loss. When they buy that company they can take that tax loss as against their profits, is that correct?

Mr. BARKIN. Correct.

That is what we call traffic in loss carryback.

And this is now a game of considerable size, and many names have been paraded in the public prints of men who have acquired the skill and the know-how of engaging in this traffic. And my general conclusion is that this practice is at the public expense, private aggrandizement at the public expense. These men are offsetting the taxload and the tax burden which they would ordinarily pay with somebody else's losses which they had not themselves incurred.

The original purposes of the carryback provisions of the tax law was to help the man who incurred the losses. And now it is merely an agency for helping to build up big giants on the one hand and secondly, to permit the smart speculators to advance their own interests or advance the interests of some specific group of property owners.

The current one which was dramatized, the Packard one, the Botany one, the Textron, the Wolfson complex. This entire practice has engaged such public attention and in such proportions that it is the responsibility of this committee to make a study or to call upon the Congress of the United States to make a thorough examination of it. Here is a case of mergers being accelerated by the provisions of our tax law, and, incidentally, I might say, causing great harm to our economy because many of these acquisitions are completely closed after the technical requirements of the law are met.

The plants are liquidated, and enterprise is discouraged.

Representative KILBURN. I absolutely agree with you. What I was thinking of is that presumably such a company may be going to the wall sooner or later. So if they bought them out for that reason and kept them going, why, presumably that would be of benefit to the economy, the workers, and everybody else. But if they close them, I agree with you.

Mr. BARKIN. Would it be appropriate in view of this discussion to have a short memorandum on this subject inserted in the record in connection with this problem, so that some of the dimensions might be indicated?

Representative REUSS. Yes. If you will submit that, Mr. Barkin, we will insert that in the record.

Mr. GRAY. May I add two suggestions to what Mr. Barkin has said? I agree with his analysis. But I would like to stress two additional points.

In the first place, from the point of view of the Federal Treasury, which is in considerable distress these days, one must remember that this device deprives the Treasury of millions of dollars which should come in under the regular tax laws if they were not nullified by this arrangement.

And, secondly, and in a more general economic sense, I have the feeling that these mergers are put together for no very good economic reason other than tax avoidance.

And the results, I think, are great conglomerations of irrelevant things where there is no evidence of any contribution to economic efficiency or improvements in production.

They contribute nothing to the general economic welfare, because they are conglomerates of unrelated things where the management has taken on something in which it has no technical knowledge, no skill at all. So the net result is a creation of an organization which is not economically efficient—it was not put together in the first place for economic efficiency reasons.

Representative KILBURN. I think you gentlemen have made a very good statement. I think it ought to be studied very carefully.

Representative REUSS. Thank you.

I hope, Mr. Barkin, that in your supplementary paper on this point, you will make specific recommendations for amending the present loss carryback laws so as to eliminate the abuse which you have described and, at the same time to retain the benefit of loss carryback when it is needed.

Mr. BARKIN. Correct.

We are not attacking the principle of loss carryback. We are attacking the types of abuses which have crept into it.

(The following was subsequently received for the record:)

TEXTILE WORKERS UNION OF AMERICA, RESEARCH DEPARTMENT, NEW YORK, N.Y.

STATEMENT OF THE TEXTILE WORKERS UNION OF AMERICA, AFL–CIO, BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS ON THE NEED FOR REVISION OF THE INTERNAL REVENUE CODE OF 1954 RELATING TO CARRYOVERS OF NET OPERATING LOSSES (SECS. 381 AND 382), JANUARY 7, 1958

The Textile Workers Union of America, AFL–CIO, welcomes this opportunity to express its views on the need for revision of the Internal Revenue Code of 1954 relating to carryovers of net operating losses in connection with corporate acquisitions and reorganizations (secs. 381 and 382). We are concerned with these provisions of the code not merely as representatives of the organized textile workers but because of the serious repercussions which these provisions have had throughout our economy, and particularly in the textile industry.

Section 381 of the code permits the carryover of net operating losses and certain other tax attributes by successor corporations in the case of specified tax-free reorganizations and tax-free liquidations of a subsidiary. Section 382 is designed to limit the sale of corporate net operating loss carryovers as such, and to place appropriate limitations on the use of loss carryovers by successor corporations. In practice, however, these limitations to date have not prevented the "trafficking in corporations with operating loss carryovers, the tax benefits of which are exploited by persons other than those who incurred the loss," referred to by the Committee on Ways and Means in its report on the Internal Revenue Code of 1954 (report on H.R. 8300, p. 42).

In fact, as reported by Business Week of January 14, 1956, "Tax-Loss Mergers Bloom Again." Citing the plethora of advertisements appearing in the Wall Street Journal and other financial publications, inviting buyers and sellers of "loss corporations," Business Week noted that "business is picking up again in the buying and selling of companies that have tax-loss credits. * * * For a year or so (after the adoption of the 1954 code), traffic in tax-loss companies fell off. The ads and the merger announcements got sparser. Now, however, corporate tax experts have had a good chance to analyze the revised rules and they're ready to go ahead again with mergers involving tax-loss situations. * * * Robert S. Holzman, professor of taxation at New York University's business school, says: 'There are just as many profitable companies seeking loss situations today as there were before 1954—probably more.'"

The abuse of the carryover provisions by persons intent on obtaining a tax advantage has had particularly deleterious effects on the textile industry. The owners of corporations which had suffered losses from operations during the recent periods of depressed demand have been discouraged from rehabilitating their businesses. New interests have acquired control of these corporations and have proceeded to liquidate part or all of the loss corporation's assets. In spite of the fact that these persons had not suffered any losses, they have avoided taxes on their profitable businesses by applying the loss carryovers of the liquidated corporations against the profits of the successor corporation.

The wholesale exploitation of the loopholes in sections 381 and 382 of the code has accelerated the demise of the textile industry. Many millions of dollars in taxes has been avoided through the use of a variety of carryover devices. Such tax avoidance is clearly not in the public interest. It is essential that sections 381 and 382 be revised to eliminate loopholes so that the intent of the Congress in enacting these provisions shall not be evaded.

NECESSARY REVISIONS

The following amendments to sections 381 and 382 are essential to prevent the abuse of the carryover privilege:

1. Paragraph (2) of section 381(a) should include transfers in connection with reorganizations as defined in section 368(a)(1)(B), i.e., which are the result of exchanges of stock for stock.

2. Paragraph (1)(A)of section 382(a) should recognize as a "purchase of corporation" any change in ownership in a corporation's stock which results in any one or more of the 10 persons with the greatest percentage of the fair market value of the corporation's stock owning 50 percent or more of its stock at the end of a taxable year when such person or persons owned less than 50 percent at the beginning of such taxable year or at the beginning of the two prior taxable years.

3. The period of time during which a change in the trade or business (after the purchase of a corporation) would result in disallowance of a loss carryover under paragraph (1)(C) of section 382(a) should be extended to 3 taxable years subsequent to the purchase.

4. In the event of a change in business at any time during the 3 taxable years subsequent to the purchase of a corporation, the carryover should be denied for each of the prior years in which a net operating loss deduction was claimed by the acquiring corporation.

5. Paragraph (6) of section 382(b) should provide that ownership of stock of an acquiring corporation (or of the continuing loss corporation in the case of a section 368(a)(1)(B) reorganization) shall be attributed to former stockholders of the loss corporation only in proportion to their ownership of stock of the parent corporation following the reorganization.

6. A subsection to section 382(b) should be provided which would deny the loss carryover where former stockholders of the loss corporation owned, directly or indirectly, less than 50 percent of the stock of the reorganized corporation immediately after the reorganization and a business carried on by the loss corporation was terminated in any of the 3 succeeding taxable years.

PURPOSES OF LOSS CARRYOVERS

The economic consequences of the adoption of sections 381 and 382 have been just the very reverse of the purposes which the loss carryover provision is designed to achieve. As noted in a Treasury Department study entitled, "Business Loss Offsets," published in 1947, the principal purposes of this provision are as follows:

"III. PURPOSES OF BUSINESS-LOSS OFFSETS

"*A. Equity considerations*

"In the absence of the loss offsets, the business entity whose net income becomes negative in some periods is not permitted to deduct all the expenses of earning income. To this extent, the tax on net income becomes a tax on capital. The owners of such a firm are discriminated against, because higher taxes are levied on their net income than on the income of owners of businesses with stable income.

"*B. Economic considerations*

"1. To remove impediments to risk taking: Without loss offsets, investments in assets with less risk of loss are favored over those in which the risk may be greater. Thus, the absence of loss offsets will reduce the relative investment in risky assets and ventures. Investment in such assets and ventures may be particularly desirable in the economy. Ventures may be risky because they are new firms challenging established ones or introducing new products. If successful, they may bring reduced prices in the industry they enter, or may create employment in an entirely new industry. They may be faced with a period of hard sledding and losses in their early years. If losses in this period cannot be offset against income of future periods, the prospective return from the investment is reduced relative to the return connected with a safer haven for their funds.

"2. To increase the countercyclical effect of taxes: Absence of loss offsets may also contribute to cyclical instability. In years of losses, expenditures will be held to a minimum. The making of these expenditures may be unprofitable when the firm bears their full cost but must pay a tax on the additional income they would bring in. Yet they might profitably be made if the cost of the expenditure could reduce taxes through loss offsets."

Instead of preserving equity among taxpayers, removing impediments to risk taking and increasing the countercyclical effects of taxes, the application of sections 381 and 382 of the code has created windfall tax gains for certain taxpayers, discouraged enterprises from making investments necessary for their survival, and encouraged the liquidation of existing business. This perversion of the purposes of the loss carryover provision has caused severe distress among the thousands of workers who have lost their jobs as a result of plant liquidations. In the textile industry, which has been suffering from the impact of several major factors tending to depress the economy of the industry, the use of section 381 of the code as an additional spur to mill liquidations has aggravated the industry's problems of adjustment and accelerated its demise. Instead of serving to stimulate constructive efforts to rehabilitate the industry, loss carryovers have been made use of by financial manipulators to the detriment of the industry and the public interest.

## DEPRESSED CONDITION OF TEXTILE INDUSTRY

The textile industry of the United States has been undergoing significant structural changes during the postwar period which have resulted in a marked contraction in production capacity, output, and employment. The rise in the standard of living of the American people and the shift in the population from urban to surburban dwellings have been accompanied by major changes in living habits which have reduced the relative position of apparel in the scale of consumer expenditures. At the same time, the development of new manmade fibers such as nylon, Orlon, Dacron and Dynel have caused considerable contraction in the markets for textiles made from the natural fibers, principally cotton and wool. Reductions in tariff rates under the reciprocal trade agreements program and the rebuilding of foreign textile industries along modern lines since the war have added to the difficulties faced by the domestic industry. In addition, the expansion of certain branches of the industry in the South has resulted in the intensification of competition for northern plants.

As a result of these developments, the textile industry of the United States has been reduced on net from 3,236 establishments in 1947 to 3,015 in 1954. Actually, the net reduction in cotton yarn mills was 119 establishments and in woolen and worsted fabric mills, 152 establishments. Publicly announced liquidations of basic textile mills from 1946 through 1956 numbered 660, with 180,000 production workers losing their jobs. Curtailment of operations in the remaining plants has resulted in a net displacement of 167,000 additional workers as total employment fell from 1,252,000 in 1946 to 905,000 production workers in October 1957.

With the industry undergoing such a drastic contraction, the struggle for survival among the remaining units has been intense. Four and one-half billion dollars has been invested since the war in modernizing productive capacity, principally machinery and equipment. These expenditures have been accompanied by greater use of advanced management techniques and improved plant layouts and processing methods. Output per man-hour has risen sharply, from an average 7.8 yards of cloth in 1947 to 11.8 yards in the first half of 1957, a jump of 60 percent in 9½ years.

Any textile enterprise which failed to keep pace with the growing productivity of the industry could not long survive in this competitive milieu. The situation demanded the best creative efforts of management and labor to insure mutual survival.

## IMPACT OF SECTION 381

The adoption of section 381 of the Internal Revenue Code of 1954 injected a new and disturbing element into this situation. The owners of corporations which had suffered substantial losses found that they owned a valuable asset in their corporate tax-loss position. People who were operating a profitable enterprise were anxious to acquire the loss corporation's "tax shoes" so they could reduce their tax liability. Lured by the blandishments of attractive offers of tax-free exchanges of stock, complete with the advantages of the capital gains treatment for their profits, many could not resist the opportunity of selling out. Why continue the competitive struggle with its demands for new investments for modernization when selling out yields a handsome and quick return?

In many cases the interests which acquired these loss corporations had no interest in continuing the operation of the company's facilities. Once the right to the loss carryover was achieved, the acquired plant or plants were liquidated. Frequently the funds yielded by textile mill liquidations were used by the new owners to buy up nontextile companies. Thus the resources of this depressed industry were diverted from the much-needed task of rebuilding it.

This process has operated to the benefit of those who sold their stock and to the interests which have acquired their "tax shoes". But their gains have been achieved at the expense of the workers who lost their jobs, the communities which have become distressed areas, the industry whose problems of adjustment to diversity have been aggravated, and the Federal Treasury which has been deprived of tax revenues. In short, the windfall gains of the few have been won at the expense of the public welfare.

Information on the effects of the use of the carryover device are necessarily limited. Many of the deals are made between closely held corporations and details are not divulged. Information made available by public corporations is also limited. Nevertheless, sufficient information has been made public to yield a clear picture of some of the patterns which have developed in the exploitation of this tax loophole in the textile industry.

### ACQUISITION OF LOSS CORPORATIONS AND LIQUIDATION OF THEIR PLANTS

Textile companies with loss records have been purchased by various interests, some of which had no previous experience in textiles, and within a year or two, much if not all of the facilities for producing textiles have been liquidated. In many cases, the proceeds of the liquidation have been used to acquire other corporations engaged in unrelated businesses. The corporations which incurred the losses have been used to set up a favorable tax position for corporations which are not, in essence, the same as the corporations which had suffered the losses. The following cases illustrate the manner in which the law has been manipulated for private gain and public loss:

*A. Acquisition by corporations in unrelated businesses*

1. The stock of the Wanskuck Co., a major producer of worsted textiles with a record of losses in prior years, was purchased by the New England Butt Co. in September 1955. The latter is engaged in the manufacture of iron castings and machinery. In May 1957, the 3 textile plants of the Wanskuck Co., located in Providence and Oakland, R. I., were liquidated, displacing 1,300 workers.

2. The stock of Boott Mills, a cotton textile company with reported losses in 1951–53, was purchased by O.D.C., Inc., a subsidiary of the Overseas Discount Corp. in December 1954. The latter is a holding company for various international investments. In June 1955 the Boott Mills operations were discontinued and its facilities in Lowell, Mass., liquidated. Five hundred workers lost their jobs.

3. John L. Fead & Sons, Inc., a knit goods manufacturer, was purchased by the United Industrial Syndicate, Inc., in November 1954. The latter is a holding company for various manufacturing enterprises. In January 1955, the Fead plant in Port Huron, Mich., was closed, throwing 60 workers out of their jobs.

*B. Purchase by textile companies*

1. The stock of A. D. Juilliard & Co., a cotton and wool textile manufacturer, purchased through an exchange of stock with United Merchants and Manufacturers, Inc., a diversified textile corporation, in August 1953. The latter's annual report to stockholders for the year ended June 30, 1954, includes the following reference to its acquisition of Juilliard and the resulting tax position:

"During the year the corporation acquired the outstanding capital stock of a subsidiary company and, in connection with the discontinuance of certain operations of the acquired subsidiary prior to and following the time of acquisition, losses were realized from the liquidation of inventories, the closing of mills, and the sale of real properties. These realized losses and additional anticipated liquidating losses were provided for either prior to or as of the time of acquisition and, therefore, are not included in the accompanying consolidated statement of income which includes the operations of the subsidiary company only from date of acquisition. The corporation estimates that the deductions of such liquidating losses (to the extent realized) and the use of carrybacks and carryovers of operating losses of subsidiary companies for purposes of computing Federal taxes on income resulted in a provision for Federal taxes for the year ended June 30, 1954, which was approximately $1,300,000 less than would have been required had such factors not entered into the tax computation.

"As at June 30, 1954, the unused loss carryovers of subsidiary companies for Federal and Canadian tax purposes approximated $14 million."

The Juilliard worsted textile plant at Providence, R.I., employing 2,200, was closed in September 1953. The Juilliard woolen mill at Stottville, N.Y., employing 800, was closed in April 1954. The Juilliard cotton mill in Brookford, N.C., employing 475 workers, was closed in December 1956.

2. The stock of Forstmann Woolen Co., a major wool textile company, with losses aggregating $6,600,000 in the previous 3 years, was purchased through an exchange of stock with J. P. Stevens & Co., Inc., a diversified textile company, in June 1957. In October, the liquidation of the Forstmann plant at Garfield, N.J., with 1,700 employees, was announced.

*C. Acquisition and liquidation, followed by acquisition of unrelated businesses*

1. Gera Mills, Inc., a wool textile company with substantial prior losses, was purchased by the Cleveland Arcade Co., a warehousing concern, in December 1953. In April 1954, the Gera woolen mill in Passaic, N.J., was liquidated, displacing 800 workers. In August 1954, the company's name was changed to Gera Corp. and its certificate of incorporation changed so as to permit it to "carry on any manufacturing, mercantile, or other business whatsoever." It proceeded in November 1954 to acquire two corporations engaged in unrelated businesses (Chatham Electronics Corp. and Otis Terminal Warehouse Corp.). In March 1955, Gera Corp. acquired U.S. Finishing Co., a textile dyeing concern. A letter from the latter company to its stockholders dated January 28, 1955, referred to Gera's tax position as follows:

"Furthermore, Gera Corp. had losses arising from other operations, which it is believed can be offset for Federal income tax purposes against earnings from the business to be acquired from the company, and from its own electronics and other divisions, which otherwise would be subject to tax."

In January 1957, the Jewett City, Conn., plant of U.S. Finishing was liquidated, throwing 550 workers out of their jobs. In October 1957, Gera was reported to have acquired the Triplex Corp. of America, a manufacturer of engine pistons. The bulk of Gera Corp.'s current business is now carried on in nontextile fields.

2. An outstanding instance of the milking of a textile company by nontextile interests for tax purposes and the subsequent application of the company's tax position for the acquisition of unrelated businesses is the case of Botany Mills, Inc. The controlling stock in this wool textile company had been owned for generations by the family of Charles F. H. Johnson. In May 1953, Bankers Securities Corp., an investment firm, and H. Daroff & Sons, Inc., a clothing manufacturer, each acquired half of the Johnson family stock. In August 1954, a syndicate headed by A. M. Sonnabend, a real estate and hotel operator, took over the controlling share of the company's stock. The company's annual report for the year ended December 31, 1955, described its carryover credits as follows:

"Based upon consolidated Federal income tax returns filed and to be filed, the company has net operating loss carryovers which may be availed of to reduce the consolidated taxable income of the members of the group whose income is consolidated for income tax purposes, during the succeeding tax years by approximately the following amounts:

| | |
|---|---|
| "Next 5 years | $3,700,000 |
| "Next 4 years | 8,100,000 |
| "Next 3 years | 9,500,000 |
| "Next 2 years | 14,700,000 |

"It is expected that approximately $3 million of estimated losses provided for in the net loss for the year ended December 31, 1955, will be taken as deductions for tax purposes subsequent to that date. Such amount is not included in the net operating loss carryovers shown above. All of the net operating loss carryovers set forth above are subject to those provisions of the Internal Revenue

Code of 1954 and the regulations issued thereunder which pertain to consolidated returns."

The recognition of the role of the carryforward was described in a company letter to stockholders, dated February 2, 1956, in which the chairman of the board urged the adoption of a recapitalization plan. He noted: "Our principal asset, a tax loss carryforward of over $13 million, I fear, will be largely lost and our securities greatly depreciated in value without approval of this recapitalization plan."

In the annual report to stockholders for 1955 the board chairman notes:

"Our losses for the past 4 years and to be sustained in 1956 on account of liquidating sales of inventory and machinery will amount to approximately $18 million. It is my confident belief that this amount can be earned by our company during the coming 6 years and, because of favorable income tax provisions, can be retained to restore the stockholders' equity."

In 1955, the company acquired two other businesses which it operates as wholly owned subsidiaries: Botany Cottons, Inc., cotton textiles, acquired in June 1955; Rolley, Inc., suntan lotion manufacturer, acquired in October 1955.

The Passaic, N.J., woolen mill of Botany, employing 2,000 workers, was liquidated in January 1956.

From 1956 to date, 10 additional corporations have been added as wholly owned subsidiaries, 6 of them in nontextile fields:

| Company | Date acquired | Product |
|---|---|---|
| Glenoit Mills, Inc | June 1956 | Fur fabrics. |
| Baltimore Luggage Co | July 1956 | Luggage. |
| Jos. H. Meyer Bros | October 1956 | Pearls. |
| Markson Bros | November 1956 | Retail clothing. |
| Calvine Mills, Inc | January 1957 | Cotton textiles. |
| Moss-Gordon Lint Cleaner Co | March 1957 | Machinery. |
| Premier Knitting Co | March 1957 | Sweaters. |
| Horsman Dolls, Inc | March 1957 | Dolls. |
| United Supply & Manufacturing Co | June 1957 | Distributor of oil field gear. |
| Smartee, Inc | November 1957 | Knitwear. |

3. Another illustration of the diversion of resources from a textile operation to an unrelated business by a new owner is afforded by the case of Powdrell & Alexander, Inc. The controlling interest in this cotton textile company was bought by George Meehan in June 1954, whereupon he became president of the company.

Following the change in management, a series of important steps took place. In November 1954, the company closed its cotton textile mill and liquidated the subsidiary Gosnold Mills Corp. in New Bedford, Mass., displacing 1,600 workers. In June 1955, it sold its dye plant at Danielson, Conn., to a new concern called Danielson Finishing Co. The various facilities and pieces of equipment at the Connecticut and New Bedford, Mass., mills were sold. The funds thus obtained were then employed to acquire the Pepsi-Cola Bottling Co. of Cincinnati, Ohio, in January 1955.

From its operations, it is apparent that the new management desires to get out of the textile business and use the loss carryover credits, not to rebuild the textile operations, but to obtain tax advantages through the acquisition of profitable nontextile enterprises. In the years 1952 through 1954, it recorded losses of $2,744,885, which it wanted to employ for tax avoidance. It acquired the bottling division as a means of earning just enough money to offset the firm's loss over credits. The speculative nature of this operation is suggested by a footnote to the annual report to the stockholders for 1955.

"On January 22, 1955, the company acquired the business and assets and assumed the liabilities of the Pepsi-Cola Bottling Co. of Cincinnati, Ohio, and has since operated that business as a division of the company. The company entered into a long-term employment contract with the manager of the bottling division which provides, among other things, that, when the bottling division shall have earned an aggregate net profit of $3 million before taxes on income, the company will sell to a new corporation, to be organized for such purpose, all of the assets of the bottling division, except cash and accounts receivable, at the book value of such assets at the date of sale. The company will own 60 percent of the stock of this new corporation and the manager and another employee will have the right to acquire 40 percent of such stock. The net profit of the bottling division for the current year, before Federal taxes on income, amounted to $599,535."

It is important to note that, for this period, 1952–54, the net operating loss before taxes was $2,744,885 and that the company has arranged to dispose of its bottling operations to a new firm after these operations yield $3 million income before taxes. While the employment agreement with the manager of bottling operation was canceled at the end of 1956 and replaced with a new arrangement giving him stock option rights in Powdrell & Alexander, Inc., the 1955 agreement casts a significant light on the motives of management.

Another interesting fact was revealed in the president's letter to stockholders, appearing in the annual report to stockholders for 1956. The letter discloses the following:

"In 1956, land was purchased in Cincinnati, Ohio, the home of the bottling division, part of which is being held as a future site for a new bottling plant. The remaining industrial property is being developed for resale."

The balance sheets for year end 1955 and 1956 show the following items:

| | 1955 | 1956 |
|---|---|---|
| Land | $5,165 | $165,000 |
| Land held for investment | | 408,888 |

The above would seem to indicate that the company may now be entering the real estate business. Income received thereby may possibly be offset by the carryover credit. The corporation's charter was amended in 1954, permitting engagement in any business the directors may determine.

4. The classic case of the use of mergers to erect a tax shelter, with tragic consequences to the employees and communities involved, is that of Textron, Inc. This company was formed by a merger of American Woolen Co., a wool textile firm; Robbins Mills, Inc., a synthetic textile manufacturer; and Textron, a cotton and synthetic combine, in February 1955. The American Woolen Co. notice of a special meeting to consider the merger, dated January 6, 1955, made the following reference to the subject of carryovers:

"As at the end of October 1954, the portions of the consolidated net operating losses attributable to each constituent corporation which may be succeeded to and taken into account by the merged corporation are estimated at approximately $18,750,000 for American Woolen, $10 million for Robbins and $1,300,000 for Textron, or an aggregate of approximately $30,050,000. Such amounts will, subject to the applicable provisions of the Internal Revenue Code, be available as loss carryovers to be offset against future earnings for Federal income tax purposes. Such loss carryovers, to the extent not utilized, will expire at the end of 1956 to the extent of $200,000, at the end of 1957 to the extent of $14,250,000, and at the end of 1958 to the extent of $15,600,000."

In his letter to stockholders of February 26, 1957, Board Chairman Royal Little boasted that "since the merger * * * (on) February 24, 1955, we have disposed of 36 textile properties and 5 textile converting divisions." These textile plants had employed approximately 20,000 workers before they got caught up in Mr. Little's tax-saving scheme.

Textron has used the resources released by the disposal of textile properties to buy up no fewer than 14 companies, 13 of which are in unrelated businesses, with products varying from storm windows to steamships. All but the textile operations are carried on as divisions of the company, which reports its income in a consolidated statement. The textile operations, which comprise only a small fraction of the company's sales, are conducted by a subsidiary, Amerotron Corp., whose accounts are also consolidated in the Textron statement. (See app. I for list of Textron divisions showing dates of acquisition and products.)

In the year ended December 29, 1956, the company reported consolidated net profits of $6,502,592. No corporate income tax was paid.

A note on taxes in its financial statement reads as follows:

"Taxes: The Federal income and excess profits tax liability of the company and its subsidiaries is subject to final determination by the U.S. Treasury Department for the years subsequent to 1945. Management is of the opinion that there is no material liability with respect to the open tax years. No provision for Federal income taxes was required on 1956 income due to losses during the year on the disposal of plant properties and equipment, which losses were charged to reserves previously provided.

"As at December 29, 1956, the company had unused Federal tax loss carryovers of approximately $45 million. Under the present tax laws these loss carryovers may be applied, subject to the applicable provisions of the Internal Revenue Code, as an offset against future earnings for Federal income tax purposes. To the extent not utilized, approximately $14 million of the loss carryover will expire at the end of 1957 and $20,500,000 at the end of 1958."

5. Another example of the use of the merger route for the transfer of a loss carryover from one corporation to another and the subsequent liquidation of the bulk of the loss corporation's facilities, is provided by the experience of Utica Knitting Co. Controlling interest in this company was achieved by a group headed by Jerome A. Newman, a financier, in March 1952. In December 1952, the company was merged with J. T. Flagg Knitting Co. in an assets-for-stock deal and the reorganized company became Flagg-Utica Corp. The annual report of the company for the year ended December 31, 1952, stated:

"Net loss was $1,216,292, after giving effect to a Federal tax carryback of $350,000 and after giving effect to the approximately $10,000 earned by the Flagg division during December. Under the Federal tax laws, a portion of this loss may be carried forward for a period of 5 years and, to the extent that the corporation has earnings for this period, will be available for reduction of taxes payable."

Between 1953 and July 1, 1955, the company's plants (all previously operated by Utica Knitting) in Utica, Clayville, and Sherburne, N.Y., were permanently closed. These mills had produced knit goods and had employed a total of 1,300 workers.

## LOOPHOLES IN THE LAW

The deficiencies in section 382 of the code which have resulted in the widespread abuse of the carryover provisions are as follows:

1. Section 382(a), relating to the disallowance of a carryover in the case of a purchase of a corporation and a change in its trade or business, defines purchase so narrowly that it does not apply to many cases in which effective control is purchased. Before disallowance of the carryover is imposed, paragraph (1)(A) of this section requires that any one or more of the 10 persons who own the greatest percentage of the fair market value of a corporation's stock at the end of the taxable year must have increased their holdings by at least 50 percentage points over their holdings at the beginning of the taxable year or the begining of the prior taxable year. This means that if such persons increased their holdings from 10 percent of the total to 50 percent, the limitation of section 382(a) would not apply. Obviously, ownership of 50 percent of a corporation's stock represents control; this is the measure of control recognized in section 269 of the code, relating to the acquisition of control of a corporation to evade or avoid income tax.

2. The period of time during which a change in the trade or business (after the purchase of a corporation) would result in the disallowance of a loss carryover under section 382(a) is inadequate. The limitation of section 382(a) to cases in which stock ownership has changed since the beginning of the current taxable year or the beginning of the prior year means that the old business need often be continued for only a little more than a year. For example, assuming that a corporation's taxable year is the calendar year, if its stock changes hands in December 1956, then the business carried on by the corporation at that time need only be continued until January 1958. In special cases this period may be even further reduced. For example, if the stock of the loss corporation had been owned prior to its sale by another corporation with which consolidated returns had been filed on a calendar year basis, the period from the beginning of the calendar year to the date when the sale of stock broke the affiliation would be a period for which a return should be filed and therefore a taxable year within the definition in section 441(b) of the code. The period from the date of sale to the end of the calendar year might be a separate return period and also, by definition, a taxable year. If the sale took place on November 30, 1957, and the loss business was terminated on January 2, 1958, it might be argued that there had been no change in stock ownership since the beginning of the taxable year 1958 or the beginning of the prior taxable year on December 1, 1957, and that section 382(a) accordingly had no application.

3. If a change in the nature of a business occurs within the specified period after a corporation's purchase, the loss carryover is denied under section 382(a) for the year in which the change in business occurred; however, any net operating loss deductions made in prior years are not affected. This means that a corporation can purchase a loss corporation, offset the entire amount of the carryover against profits in the first taxable year or two, and then terminate the business of the former loss corporation without penalty.

4. Under paragraph (3) of section 382(a), the rules of attribution set forth in section 318 (relating to constructive ownership of stock) are used in determining the ownership of stock, except for the requirement that 50 percent or more of the stock of a corporation be owned by a person before such corporation shall be considered as owning the stock owned by or for that person. The omission of this 50 percent limitation requires that all the stock owned by an individual be attributed to a corporation in which the individual has any share, no matter how small. This would permit the evasion of the limitation imposed by section 382(a) in the following type of case. Assume X owns more than 50 percent of the stock of Corporation A, which has a loss carryover, and X also owns a single share of stock in Corporation B. Corporation B buys 100 percent of the stock of Corporation A. This purchase would not be subject to section 382(a) since more than 50 percent of Corporation A's stock was acquired from X, whose ownership of that stock was attributed to Corporation B.

5. Under section 382(b), relating to the limitations on loss carryovers where changes in ownership are the result of a reorganization, there is no requirement that the successor corporation continue to carry on the same trade or business. This omission creates a most significant loophole since it permits persons desiring to obtain tax loss carryovers to do so without regard to the disposition of the business of the acquired loss corporation.

6. In listing the types of reorganizations which are subject to the limitations of section 382(b), the statute omits transfers which are the result of exchanges of stock for stock (sec. 368(a)(1)(B)). This means that the owners of the loss corporation involved in this type of reorganization need not obtain a 20 percent interest in the successor corporation in order for the latter to use the loss carryover. The successor corporation can achieve this and either by transferring income-producing assets to the loss corporation or by liquidating it so that the carryover would go to the parent company. In the latter case, the transaction should be treated in the same manner as a purchase of stock and be made subject to section 382(a).

7. While the Senate Finance Committee's report on H.R. 8300 states that "the 20 percent (continuity of interest) requirement (in sec. 382(b)) cannot be watered down by inserting one or more corporate entities between the corporation with the loss and the corporation deducting the loss," it is silent on the possibility of watering down the 20 percent requirement through other devices. For example, in a reorganization in which substantially all the assets of a loss corporation are acquired by a subsidiary (which can be newly created) of a profitable corporation in exchange for the latter's stock, the continuing interest of the loss corporation's stockholders can be watered down as long as they receive stock in the parent company of a value of 20 percent of the fair market value of the subsidiary. The parent company can then make use of the loss corporation's carryover by transferring income-producing assets to the subsidiary which had acquired the loss corporation's assets.

THE REMEDY

The above listing of loopholes is not exhaustive. Rather it is suggestive of the obvious need for revision. Certainly the provisions of section 269, which is designed to prevent abuse by authorizing the disallowance of a deduction where control of a corporation is acquired for "the principal purpose * * * (of) evasion or avoidance of Federal income tax," cannot be relied upon to put a stop to the trafficking in loss corporations for the benefit of persons other than those who incurred the loss. As noted by the Report of the Committee on Ways and Means on H.R. 8300 (p. 32), "the effectiveness of this provision has been impaired by the difficulty of establishing whether or not tax avoidance was the principal purpose of the acquisition."

The ineffectiveness of section 269 as a bar to abuse is a fact of common knowledge. Thomas N. Tarleau has summarized the situation in his paper, "The Place of Tax Loss Positions in Corporate Acquisitions," published by the

Joint Committee on the Economic Report in "Federal Tax Policy for Economic Growth and Stability (1955)," in the following words:

"Section 269 has not worked well. The courts have been reluctant to find the prohibited motivation in the cases which the Government has brought before them. * * * With section 269, the judges had not only to probe states of mind, but also to select dominant motives from the several purposes which generally lie behind the acquisitions covered by the section. In case after case the courts found enough legitimate business purpose to set aside the application of section 269."

In the words of Jackson L. Boughner, writing on "Tax Problems of the Buyer of a Going Corporate Business Under the 1954 Code," in the Journal of Taxation, July 1956, section 269(a) "has been on the books since World War II, and has had practically no effect whatever. Almost every transaction can have some business purpose attributed to it."

The addition of subsection (c) in the 1954 revision of the code will not materially improve the effectiveness of section 269. The new section raises a presumption that an acquisition has tax avoidance as its purpose if the purchase price is substantially disproportionate to the adjusted basis of the property of the acquired corporation plus the tax benefits acquired as a result of the acquisition. The operation of the presumption is uncertain, particularly since the basis of assets held by the acquired corporation may or may not bear any real relation to the actual value of the assets. In any case, the new provision simply adds a presumption which may be rebutted by the taxpayer. In fact, the finding of the Commissioner under the former statute that an acquisition had been made with a tax avoidance purpose automatically raised a similar presumption, and little or no force has been added to the section by the new language.

It is evident therefore that the only effective remedy for the widespread abuse of the carryover provisions is to close the loopholes in sections 381 and 382. This can be accomplished, as proposed above, by denying use of the carryover in the case of a change in ownership of a corporation if a business is terminated at any time during the 3 years subsequent to the date of the change. This rule should be applied whether the change in ownership is a result of a purchase of the corporation's stock or a reorganization. This would put an end to the exploitation of tax benefits by persons other than those who incurred the loss through trafficking in corporations with loss carryovers.

REPORT OF ADVISORY GROUP ON SUBCHAPTER C

The remedy proposed by the advisory group on Subchapter C of the Internal Revenue Code of 1954[1] would limit the available carryovers of an acquired business to "50 percent of the consideration paid for that business" and would delete the requirement for continuation of a business from section 382(a)(1)(C), substituting a provision in section 269 making it a presumption that an acquisition is for a purpose condemned under that section if the business of the acquired corporation is discontinued.

Unfortunately, this remedy appears to create more problems than it solves. The proposed limitation of carryovers to 50 percent of the consideration paid for a business is at best arbitrary. At worst, it could operate capriciously in permitting certain corporations the full benefit of carryovers in spite of the tax avoidance motive involved in an acquisition while preventing other corporations from utilizing their full carryover rights where no abuse is involved. The relationship between carryover and the amount paid for a loss corporation is not the cruicial consideration. A loss corporation with relatively substantial net assets might well be acquired by another corporation at a price several times the amount of its carryover (thus assuring allowance of the full carryover) yet subsequent events might clearly establish the abusive character of the transaction. The crucial question is whether the business formerly conducted by the loss corporation is continued by the acquiring corporation. It is the liquidation of such businesses that has constituted the gross abuse of the carryover provisions, with its dire consequences for the affected workers and communities.

The advisory group recognizes that "the proposed mathematical tests would not reach such cases (acquisition of a 'shell' corporation or a going business

[1] Report on Corporate Distributions and Adjustments, by the advisory group on Subchapter C of the Internal Revenue Code of 1954, House Ways and Means Committee, 1957, pp. 74–78.

with no idea of continuing it)." However, the protection which the advisory group suggests against this type of abuse is actually weaker than the present provision. Under section 382(a)(1)(C) a purchased corporation which has not continued the trade or business conducted before its purchase automatically loses its carryover. The advisory group would delete this objective rule and substitute for it a general proposition that the discontinuance of the corporation's trade or business shall be considered "a presumption that [the] acquisition is for one of the purposes condemned by section 269."

We have commented above on the ineffectiveness of section 269 as a bar to abuse. The addition of the presumption in subsection (c) in the 1954 revision of the code has not materially enhanced the effectiveness of section 269. The addition of another presumption can hardly accomplish the stated purpose of the advisory group. Indeed, the group's report admits that the proposed addition "is cast in general terms which are uncertain in application to specific cases."

In view of the importance of the objective rule in section 382(a)(1)(C) in preventing the gross abuse with which we are primarily concerned, it is imperative that this rule be retained and, indeed, strengthened, as suggested above.

### CONCLUSION

The Congress has recognized the need to restrict the carryover of losses in accordance with economic realities rather than such artificialities as the legal form of a reorganization. It has sought to insure that the benefit of the carryover shall not be exploited by persons other than those who incurred the loss. However, the limitations provided in section 382 of the Internal Revenue Code of 1954 have proven to be too loose to accomplish its purpose.

Abuse of the carryover privilege has become as rife under the new code as it had been under the previous statute. Loss corporations have been acquired by new interests, either through purchase or reorganization, and all or part of their businesses liquidated within a short time, without impairing the acquiring corporation's right to claim the loss carryover. The proliferation of advertisements for the sale or purchase of loss corporations is clear proof that trafficking in corporations with loss carryovers is growing rather than being retarded.

In the textile industry, the application of the carryover provisions to corporate purchases and reorganizations has accelerated the liquidation of many operating units. It has discouraged long-established enterprises from making the investments necessary for their survival. They have succumbed to the lure of a deal with outside interests intent on exploiting the loss corporation's carryover. As a result, many thousands of workers have lost their jobs and once-thriving communities have become ghost towns.

The windfall gains of the predatory manipulators of these deals run into hundreds of millions of dollars. These gains are won at the expense of the U.S. Treasury and the public welfare. Action is imperative to plug up the loopholes which make possible this mulcting of the Federal Government. Equity and public policy demand that the carryover be denied to any taxpayer who terminates the business which incurred the loss if he does so within 3 years of acquiring it.

APPENDIX I.—*Textron subsidiary and divisions, December 1957*

| | Date of acquisition | Product |
|---|---|---|
| Subsidiary: Amerotron Corp. | | Textiles. |
| Divisions: | | |
| Benada Aluminum Products Co. | April 1956 | Storm windows. |
| F. Burkart Manufacturing Co. | September 1953 | Batts, pads. |
| California Technical Industries | September 1957 | Electronic equipment. |
| Camcar Screw & Manufacturing Co. | September 1955 | Metal parts, screws, fasteners. |
| Campbell, Wyant & Cannon Foundry Co. | April 1956 | Iron and steel castings. |
| Coquille Plywood | September 1955 | Plywood. |
| Dalmo Victor Co. | January 1954 | Radar, electro-mechanical devices. |
| Federal Industries | August 1956 | Coated fabrics. |
| General Cement Manufacturing | April 1956 | Cement, chemicals. |
| Hall-Mack Co. | June 1956 | Bathroom accessories. |
| Homelite Co. | July 1955 | Chain saws, pumps, generators. |
| Kordite Co. | October 1955 | Plastic products. |
| Steamship Leilani | July 1956 | Steamship. |
| M. B. Manufacturing Co. | March 1954 | Vibration testing equipment. |

Representative REUSS. I was just going to ask the members of the panel to comment on each other's statements. Please start off, Mr. Barkin.

Mr. BARKIN. I have one general comment on Mr. Frucht's statement which deals primarily, if I understand it, with the problem of entry, the entry of new competitors into an industry, as providing a ceiling on administered prices or on the prices which may be charged by corporations or concerns or businesses in specific industries.

The major discussion centered on the part of the drugstore as a homely illustration. Fortunately, or unfortunately, I live in a small suburb outside of New York, and I sometimes don't have much choice but to buy some drugs at these drugstores in my own town. Ordinarily I wouldn't do it. The difference in price is quite huge; sometimes varying from 50 to 70 percent, because we enjoy some advantages in New York City proper.

One major one is that we have discount houses both for drugs and many other articles. And the contrast in price is great.

The important fact obviously is that the establishment of even so simple a matter as a drugstore entails great investments and risks. And particularly in the suburb of a city, because the potential enterprise is aware of the fact that purchases will be made at some center city; a core city; and purchases at the local shop are likely to be selective and emergency.

And we therefore have this tremendous span in prices.

But aside from that we also are aware of the difficulties of entry. The steel industry has had no new company entering into it since the war. And these are illustrations which can be duplicated in many, many industries.

Consequently, the right of entry is not adequate ceiling in our society where the investments and the requirements for new entry are huge. We have one illustration which may be helpful.

Johns-Manville has just bought a Fiberglass company which had been previously owned by Libbey-Owens-Ford. And the reason for the purchase according to the public press is that Libbey-Owens-Ford didn't have the appropriate distribution system in order to sell the merchandise and the products of the Fiberglass corporation.

This is another illustration of the great technical business structures required in order to assure adequate entry.

I would like to make a few comments on Mr. Massel's paper. I think that basically he has exaggerated the degree of rigidity in the labor sector of the economy and the immobility.

Fortunately in this connection I can even document my comments, which is not always possible. Because in the December issue of the American Economic Review, we have an article called "Do We Have a New Industrial Fuedalism" by the economist at the University of California, Arthur M. Ross.

In this article he deals precisely with the question Mr. Massel has raised, namely, has there truly been a reduction in turnover, a rigidity, a less flexibility in our labor force, more tieing of skilled labor to a plant, and more stability in employment because we are moving off to a greater proportion of nonproduction workers.

Whether or not this article is reproduced in the record is something that the chairman might consider. But the general conclusion of this article is that the conclusions similar to those which Mr. Massel has presented do not hold up under close analysis; that there is no greater immobilization—he dramatically calls it industrial feudalism—but more precisely there is no more—there is no less fluidity in our industrial society at the present time than—particularly with respect to labor mobility—than there was before.

I think a careful study of the turnover and employment of nonproduction workers during this recession will also indicate that that group is much more mobile than was indicated.

Probably some of the inflexibility of cost to which he has alluded is due to voluntary inflexibilities introduced by the large corporation through their theories of accounting and of cost overhead which remains relatively inflexible if you don't vary the overhead in terms of rates of operation.

Many other items, research and others, remain rigid if management determines that they shall be rigid in that respect.

So that my conclusion is that it is our large business structure which permits the management not only to administer prices, but to administer their own accounting systems and their own systems of price determination, to which he is referring, but that the normal elements of cost—that is, the flexible elements of cost in the labor have not become any less mobile than they were before, and are fortunately dated—supporting the conclusion I have just mentioned is documented by this study by Professor Ross.

Mr. Massel. I think that Mr. Barkin has intermingled two separate factors. One is the mobility of labor in the sense of labor's ability to move around. The other is the size of the labor force in an individual plant. Even though workers can and do move around this mobility does not tell us what has happened to the size of the labor force in the individual plant. It does not tell us whether the labor force is reduced in proportion to reductions in production, or whether the labor force is maintained on a more stable basis. This question of stability affects cost structures.

The issues of mobility of labor and of the regularity of employment are related in some respects, but they are not quite the same.

Insofar as the issue of mobility of labor is concerned, I did not make the statement nearly as broadly as Mr. Barkin interpreted it. In talking about the mobility of skilled and technical people I referred to an issue which the committee raised with the panel. The issue is not whether skilled and technical people do move around, but whether there is as much mobility as the economy needs for growth and stability.

In that connection I suggested that skilled and technical people do not move around as much as they might, partly because of the natures of pension plans. Because many pension plans do not provide for vesting, it has become difficult for many skilled and technical workers to move to other companies. Therefore, we do not have as much mobility as we might have otherwise.

Senator O'Mahoney. Well, do you take the position that mobility of labor is a desirable factor?

Mr. Massel. Yes, sir, I do. Not that labor should be forced to move around, but that when companies need labor, especially skilled and technical labor—and that applies especially to smaller companies—the lack of mobility of labor which makes it more difficult for them to get the skills it needs for expansion.

Senator O'MAHONEY. Well, would you go so far as to say that the sort of migratory labor we find in some agricultural operations is a desirable thing?

Mr. MASSEL. No, sir; I do not think of that as being desirable. And I would not think of mobility, in the sense of job insecurity, as desirable. I referred to mobility in the sense of skilled and technical labor force's ability to move more easily. Not being forced to move, but being able to move.

Senator O'MAHONEY. You believe in stability of jobs.

Mr. MASSEL. Yes, sir.

Senator O'MAHONEY. You believe in full employment.

Mr. MASSEL. Yes, sir.

Senator O'MAHONEY. Have you given thought to the problem of providing full employment when the employers are not people but are organizations of people managed by experts whose first motive, of course, is to make a profit for the stockholders who own the organization but do not exercise any real function in management?

Mr. MASSEL. I am sorry, sir, I do not get the question.

Senator O'MAHONEY. Well, perhaps I didn't state it very clearly. I point out to you that in the modern industry, and now to a degree in modern agriculture, we find operations being carried on by organizations which are created by the States. When the Constitution of the United States was formed and the preamble of that Constitution written, there were not more than half a dozen corporations outside of banks in the Thirteen Original States. The economy was carried on through individuals, with individual property, skills, and their power to hire neighbors, and to form partnerships. But as technological advances took place we gradually found the corporation coming in.

And now the corporation, the trade union, the trade association, and other organizations have taken over the management of our economy. We don't any longer now have an economy managed by individual owners. Do you agree with me on that?

Mr. MASSEL. Yes, sir.

Senator O'MAHONEY. Well, doesn't that raise a new question for society and for the Congress of devising a formula by which the rights of the people in an economy run by organization and employed managers are dominant factors?

Mr. MASSEL. I think it raises a question that we have had for some time. It seems to me that this question exists because of our technology, which requires much larger production units than we had previously.

Senator O'MAHONEY. I know it has existed for a long time, because I have been thinking about it for a long time.

Mr. MASSEL. I realize you have.

Senator O'MAHONEY. And I have tried to get better experts than I am to give thought to it, in order that we may find a method of adjusting a free democratic society to the modern organizational, industrial world in which we live.

Mr. MASSEL. But this question is set in terms of adjustment to the present world rather than of an attempt to atomize the industrial structure so that we can go back to the handicraft system with small employers.

Senator O'MAHONEY. No; of course I don't think it is possible to go back to the handicraft system. The progress of science has posed a new problem. We must retain and maintain the great values of scientific expansion and growth and technological improvement, the results of laborsaving devices and the like. We can't throw those overboard. We can't go back to the 18th or the 19th century. We must be thinking of going forward to the 21st century in which the rights of people and the general welfare will continue to be our dominant objective. Or else we have got to scrap the preamble to the Constitution. Do you agree?

Mr. MASSEL. I do agree. And it seems, sir, that it is precisely because of that fact or that in examining our antitrust policies we must remember that we do have not economic objectives only. We have significant political and social objectives at the same time. Therefore, we need further analyses of the relationships among those objectives.

We have heard, in recent years, some theories suggesting an incompatibility between the social and political objectives of our antitrust laws and the economic objectives. This rests on a theory that it is only through large enterprises that we can meet our economic objectives.

It seems to me that we badly need further analysis of efficiency, the structure of competition and the effect of our antitrust laws in order to see whether or not those goals are incompatible. Incidentally, I have a hunch that they are perfectly compatible.

Senator O'MAHONEY. Well, I rather agree with you that they are compatible. But our trouble is that we are acting under the principles and theories that were completely applicable to an individualistic society. We are no longer operating in an individualistic society; we are operating in an organized and a managerial society.

And that situation has been making it more difficult for the individual to preserve the individual's economic status.

That has brought into existence the great national and sometimes international unions, because without them, labor was at the mercy of organized capital.

Do you agree with that?

Mr. MASSEL. Yes, sir.

Senator O'MAHONEY. My own feeling has been that Congress and the leaders of industry, the leaders of labor, the leaders of Government, must come to a realization of the fact that it will be a first step in retaining the values of modern technology and scientific invention and, at the same time, the economic freedom of the individual if we get together in a conference of such leaders to define the powers and duties of the organizations that have taken over our economy.

Have I made that clear?

Mr. MASSEL. Yes, sir.

Senator O'MAHONEY. Do you agree?

Mr. MASSEL. I agree. But I would suggest, additionally, that before that conference takes place we do need much more research and more public understanding of the operation of our economy, the operation of competition, and the effect of our antitrust laws and policies. We do not have that information today.

Senator O'MAHONEY. Well, of course, the antitrust laws are based upon the theory that criminal punishment should be applied to those whose activities in the modern world can be brought under the law.

I have heard Members of Congress complain loudly because in the presentation of antitrust cases the Department of Justice frequently pursues the civil route rather than the criminal route. It seems that in many instances the steps taken by economic organizations, whether of capital or of labor, are taken because we have not had this research project which is so needed to bring about the adjustment of the individual to the modern organization.

Yesterday I introduced a bill to the Senate to make it unlawful for motor vehicle manufacturers to be the owners of credit institutions. My reason was the fact that when a giant motor manufacturer can have under its complete control, as a wholly owned subsidiary, a financial institution, it acquires the terrific power of concentrated wealth which the employee and the independent corporation engaged in financing can't begin to wield.

I think all economic history teaches us that the power of wealth is one of the greatest influences for the subjugation of the masses of the people in the economic world.

Mr. GRAY. May I comment upon your remarks?

Senator O'MAHONEY. Certainly, Mr. Gray.

Mr. GRAY. These remarks of Senator O'Mahoney get us into the larger issue of the allocation of resources.

One might think of four major resources in this connection. Our natural resources, our capital, our labor, and our technology and scientific personnel. Just those four.

The point of this discussion, I take it, is whether it is good for the society that the decisions about what should be done with these resources, the uses to which they are to be put and how they are to be used, should remain in the hands of giant corporations, acting in their own corporate interest, and frequently acting irrationally or irresponsibly from a social point of view.

The issue, it seems, in this modern monopoly question is where are the decisions to rest with respect to what we do and how we develop and manage our natural resources; what we do with the capital that accrues for new investment every year in this country; how do we distribute and employ our labor force so as to get the maximum productivity; how do we develop technology and allocate scientific personnel?

My point is that these decisions are likely not to be made properly or wisely or in the general interest if they are made by a few great giant corporations acting in their own private interest.

If these decisions cannot be made within a framework of free competition, then we must resort to some scheme for governmental assumption of responsibility for them.

Senator O'MAHONEY. I think, Mr. Gray, that you have stated a correct view of this fundamental problem. It must be remembered that when our Government was founded, the drafters of the Constitution intended that the Congress, which is the legislative branch of the Government, should have the power to make all laws relating to economic affairs that affect the whole State, the whole Union, or interstate or foreign commerce.

In other words, we have a political constitution and an economic constitution.

In the first article setting up the Congress and defining its powers the Constitution states that among these various powers is the power to regulate commerce among the States, with foreign nations, and so on. Everybody who believes in the Constitution and amendments believes in that power. But what has developed all around us is an economic government in private hands, not exercised by the Congress, not exercised by the Federal Government. And so the Federal Government has been driven to antitrust presentations, punitive laws, to bring about an adjustment to the point where the Department of Justice from time to time may act against the public interest. Because of the power of concentrated wealth these cases can be carried from the lowest court to the highest court and back again and up again. And the public interest is not protected.

I happened to be listening to a hearing many years ago during the Woodrow Wilson administration. This was a hearing conducted by one of the committees of the Senate on a Federal Trade Commission investigation of the big packers. The result of the investigation was a consent decree against the big packers condemning them and forbidding them to follow certain practices.

If my memory serves me correctly, it was 15 years before there was agreement upon the form of the decree. The formulation of that decree was batted about in the courts, while the legislative body, the Congress of the United States, was doing nothing about it. And then there came, during the administration of President Harding, who couldn't be called a radical or a leftist by any manner or means, the passage and the signing of the Packers and Stockyards Act.

And that act gave the Secretary of Agriculture more power to manage business than any law that had ever been passed up to that time.

Well, I am turning this meeting into my own lecture. And that I shouldn't do.

Representative REUSS. I think Mr. Frucht had a comment.

Senator O'MAHONEY. Yes. Mr. Frucht.

Mr. FRUCHT. There seems to be two issues, Senator, involved not just in what you said, but in what we were discussing earlier.

There is the question of market power itself, and there is the question of the effect of market power on the growth and change in the economy over time. Now these are two separate questions.

Senator O'MAHONEY. Will you state them again?

Mr. FRUCHT. The question of the degree of market power, the degree to which a firm is free of the influence of the market and the discipline of the market. And there is the question of the relation between the degree of market power and the behavior of the firm over time in its price and output policies, and so on.

Now, we have discussed both of these questions. I would like to make a point on the pricing effects of market power in a growing economy, in the first instance; particularly in relation to what Mr. Barkin said.

I am in quite considerable agreement with Mr. Barkin on the effects of market power in many contexts. If market power means anything, it means the ability of the firm to earn more than a more competitive firm can earn; it means the ability of the firm to make decisions about resources, about output, which may not be wholly in the national interest.

Now, what I want to say here is this: that if we are concerned with the contribution of firms with market power to inflation, we need not be, per se. The posession of market power will enable a firm to earn perhaps a great deal more than a competitive firm, but as its demand in an inflationary situation increases, the effects of market power will not lead to any more rapid increase in price than would be the case under very flexible pricing, such as occurs under perfect competition.

In fact, in the short run, the effects of market power would work in a reverse way.

Now, in the second instance as to the question of the effect of market power on the allocation of resources, on the efficiency with which the desires of the consumer are carried out, it is clear that excessive market power violates the free market principles on which, I presume, we are all in agreement.

Now the question is, How extensive is market power in the American economy? Can we associate market power directly with concentration?

The question becomes one of how substantial are the barriers of entry into our concentrated industries, how large entry-barring shelters exist. I would say in the first place that we perhaps tend to overestimate these barriers. As the economy grows in wealth and in complexity, in technological know-how, the possibilities of invasion of any particular market by other firms in other sectors increases.

I would suggest a priori, that with other things equal, economic growth and change in themselves tend to reduce the market power of firms in any particular industry, even if nothing else happens.

I would go on and say that where market power can be demonstrated to be substantial, it should be eradicated, if possible.

Now, there may be instances of market power due to increasing returns to size—there are, for instance, cases analogous to public utility cases where the market under no circumstances could bring about a situation where the behavior of the firm could be disciplined effectively by competition. If a market as presently constituted cannot discipline behavior in an industry, and if appropriate antitrust policy cannot restore a situation in which competition will effectively discipline the firms in an industry, then something else has to be done.

Senator O'MAHONEY. As I understand you, Mr. Frucht, you are saying that if the market power cannot operate——

Mr. FRUCHT. Or be made to operate.

Senator O'MAHONEY. Cannot be made to operate to prevent inflation, improper inflation, then some other method must be found to do it? Am I right?

Mr. FRUCHT. Well, I would say yes, with the proviso that I don't think that market power itself creates inflation or has the responsibility of checking it. I think market power has other effects.

Senator O'MAHONEY. Yes; I understand.

Mr. FRUCHT. It has other effects which are not in the social interest at all. But on this count, regarding its inflationary effects, I think market power comes off very clean.

This proposition applies on this particular count only. I would furthermore like to say this: I doubt very much that market power is nearly as extensive in the economy as many people suggest.

Senator O'MAHONEY. Yes; I understand your question. But my question to you was this: If market power does not prevent inflation, then should some other means of doing so be obtained?

Mr. FRUCHT. I am a little afraid, Senator, that we may kill the golden goose here.

Senator O'MAHONEY. Is inflation the golden goose?

Mr. FRUCHT. No; but it may result from things of which we all approve.

For instance, if we have a great deal of growth in the economy, and if it is of the nature that first you get a big expansion in demand, say, for electrical products, and then a shift in demand toward, say, steel, or raw materials, then again a big shift toward services; if we have these things going on in the economy—and we are getting more and more of such shifts in demand through research, through rather rapidly changing consumer tastes—then, under these circumstances, if we have pricing rigidities, and that means wage rigidities, too, which prevent prices from falling, so as to offset the increasing prices that economic change will create in some economic sectors, we must get some inflation.

Senator O'MAHONEY. I don't want to misunderstand you. But I am afraid what you are saying is an argument for a hands-off policy by Congress and letting the market operate at its will.

Mr. FRUCHT. Only partly.

Senator O'MAHONEY. Except for the antitrust laws.

Mr. FRUCHT. Well, not except for the antitrust laws. I would say, one, the antitrust laws are important. And I would agree with Mr. Massel that Government itself has added a great deal to the kinds of inflexibilities that help inflation to come about when you have the kind of dynamic change that we have been having.

You can't have your cake and eat it too. You can't prevent prices from going down here when demand falls and expect to offset prices from going up there where demand increases and resources are in greater demand.

Senator O'MAHONEY. Instances have been laid before this panel of cases in which demand has fallen but prices have been raised by the huge organizations.

Mr. FRUCHT. I think that is true, sir. I think that that has to do with——

Senator O'MAHONEY. Well, doesn't the Government have anything to say about that?

Mr. FRUCHT. I think the Government would be interested in all such questions.

Senator O'MAHONEY. Well, should the Government not only be interested, but should it pass legislation designed to prevent the raising of prices by huge managerial organizations when the demand has fallen?

Mr. FRUCHT. I would say this—again there is the question of market power and the related questions of cost behavior, which I couldn't possibly evaluate offhand in any specific instances.

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Senator O'MAHONEY. Well, let me give you an example. The head of one of the greatest corporations in America, if not in the world, was testifying before a Senate committee; in answer to the question as to what was the principal factor in the action of that corporate management in making prices for its products his answer was that the biggest factor was the production of "x" percent profit upon the stock.

Mr. FRUCHT. I think, sir, that many businessmen have notions of their power to generate profits which the market disagrees with overtime. And target rates of return expressed in markups over "standard costs" and profit rates are two very different things.

My point here is only this: That if at the same time that demand is falling in a highly competitive industry, say, the garment trade, costs go up there, I would be very surprised to see prices come down.

And I wouldn't be the least bit surprised to see them go up under those circumstances.

I am saying that the adjustments to cost will typically reflect—the adjustments in price to cost—will typically be such that they often will be rather quickly reflected in prices regardless of what happens to demand and pretty much regardless of the degree of market power.

Senator O'MAHONEY. Do you advocate that Congress keep its hands off this problem?

Mr. FRUCHT. I would say this: That if we are going to encounter really rapid increases in the price level I would certainly be very concerned. We have had inflationary dangers in the past, and we may again in the future. Inflation means a transfer of income from one group to another and it is an arbitrary transfer. It isn't one that we should approve of.

On the other hand, if we are faced with some inflation, some moderate annual rise in the price level because of changes in the composition of demand, and at the same time have inflexibilities in pricing and in wages, and labor immobilities, slowing down the transfer of resources, if at the same time we have certain Government policies which increase price and wage rigidities while decreasing resource mobility, then I would say that if we are going to take a very strong policy position against even a moderate degree of inflation we may be in danger of hurting ourselves more than we could possibly gain.

I would hate to see us, because of some degree of inflation, say 2 or 3 percent a year—which I wouldn't like if I could have it otherwise—I would hate to see us throttle the economy and produce effects on growth and change and on the use of resources which might be even more painful than the inflation we try to cure.

Senator O'MAHONEY. Well, is it essential to throttle the economy to free it from control by private industry?

Mr. FRUCHT. I think again the question boils down to how important we feel market power to be; market power in the hands of business and market power in the hands of unions.

Now, my position is that the case, the proposition, that market power has a stranglehold on the American economy has not been borne out. I haven't seen it borne out in a general sense in the case of business. I haven't seen it borne out in a general sense in regard to unions.

Senator O'MAHONEY. How do you suppose it has come about that the President of the United States has just announced the formation of a new committee headed by the Vice President to study the problem of inflation? Has he been misled by his advisers into abandoning the theory that you advocate that we don't have inflation sufficient to cause us concern, and that market power can, generally speaking, meet the situation?

Mr. FRUCHT. I would say that we always should be concerned with inflation. And we have had a rising price level actually since before World War II.

Senator O'MAHONEY. I would be very happy if you would be good enough after considering the discussions of the panel here today, to submit an additional paper suggesting the policy that you would advocate.

(See p. 764.)

Now, I want you to know, and I want everybody to know, that I am looking at this purely objectively. As an individual Member of Congress. I don't want to punish business. I don't want to pass any stranglehold law. I don't want to prevent the growth and expansion of the economy.

I want to see the participation in a growing economy spread broader and broader throughout the population of the United States, because I believe that in that population we have the greatest resource that it would be possible to find.

Mr. BARKIN. Senator, I would like to take Mr. Gray's proposition as a starting point and bring to the surface again the point that I was making. I think we have a twofold problem here. The one which we are discussing, the competitive pressures, the problem of market power, the problem of structure from the power side, I would like again to underscore the other aspect as well, namely, the lack of power, the lack of influence, the inadequacy of resources, the inadequacy of leadership in parts of our economy which necessarily results in a lagging rate of growth or an absence of growth.

I am hoping, therefore, that the committee, in examining this problem of structure, looks at it from both ends. The issue of the day, which I also like to dramatize and discuss as I did in my paper, is the problem of the frustration which large economic corporations and business power has created, and this we have dwelt on.

The other side as well, the fact that in many of our sectors of our economy productivity is not rising, the constituent members of the industry such as agriculture, textiles, and others, are unable to initiate through their own enterprise and through their own efforts an adequate stimulus to productivity, the chaos which is created in local government by the multiplicity of governmental units with the consequent inefficiencies and rising costs of local government administration.

Both aspects of the structure of our economy, I hope, should be given the weight in the final report and recommendations of your committee, because we don't always see both of them projected into the public arena for discussion.

Senator O'MAHONEY. I must apologize to this panel for not being present today at the beginning of this session. I wasn't able to be here yesterday. Unfortunately we serve on so many separate committees of Congress that it is never possible to attend all meetings to which one is summoned.

I was at the Judiciary Committee this morning. But I think that the statements which I find here in the various papers, the statements which I find in the President's Economic Report, have a great bearing upon this subject matter.

I would like particularly to call to the attention of the members of this panel a few statements to be found on page 53 of the President's report; under the heading, "Competition," the report reads as follows:

> The vitality of our economic system depends in large part on vigorous competition which would be enhanced by certain improvements in our antitrust laws. Congress is urged to act favorably on five proposals as follows: To authorize Federal regulation of the merger of banking institutions accomplished through the acquisition of assets; to require notification to the antitrust agencies when firms of significant size that are engaged in interstate commerce propose to merge; to grant the Attorney General power to issue civil investigative demands under which the necessary facts may be elicited when civil procedures are contemplated in antitrust cases; to make cease-and-desist orders issued by the Federal Trade Commission for violations of the Clayton Act final, unless appealed in the courts; and to authorize the Federal Trade Commission to seek preliminary injunctions in merger cases where a violation of law is likely.

And on page 55 I find this paragraph:

> Certain legislative improvements are required in programs that lie within Federal jurisdiction. Proposals will be made to the Congress to extend the coverage of the Fair Labor Standards Act. Favorable consideration is again requested for legislation to revise the ambiguous and outmoded provisions of the 8-hour laws applying to Federal and federally assisted construction projects and to carry out the principle of equal pay for equal work without discrimination based on sex.

Now, these recommendations contained in the President's report deal with mergers both of the banks and of the businesses. It strikes me that the President's report shows that the administration doesn't believe that this question of the growth of the giant banking institutions and the giant industrial organizations can be left to circumstances in the market alone. The public interest must be preserved.

I note that one of the panelists, Prof. Alfred E. Kahn, was unable to come here. I have had only a slight opportunity to glance over his paper. But I do note that he makes some interesting statements. Among them he recites, on page 4, with respect to the power of unions over wages:

> The law could of course be reframed so as to attack and dissolve the power of unions over wages and the power of noncollusive oligopoly over prices. But I am frankly uncertain that either the efficacy or the need—in terms of inflation—can be demonstrated. If the problem of administered inflation does prove to be more serious than is now evident, it might be more promising to take such steps as to prohibit price increases in concentrated industries within, say, 6 months of the negotiations of new wage agreements that raise wages, including fringe benefits, by more than say, 3 percent a year, than to take the antitrust route.
>
> I believe it is a mistake to try to impose on antitrust more than it is equipped to accomplish.

That paragraph, it seems, opens a very interesting phase for analysis and discussion.

I am rather inclined to believe that we cannot depend upon punishment under the antitrust laws to bring about the economic stability, the price stability, that we are talking about.

We must find a way, it seems, to define the powers of the organization that men create by their own authority or by the authority of the several States to exercise influence upon the national and international economy. I have often said that men are the creatures of God, but governments, corporations, trade associations, labor unions, and the like are all the creatures of men.

We are living in an era in which because of our passion for the freedom of men to do what they please we have allowed men, with the help of some of the States that have no authority to regulate interstate and foreign commerce, to create the man-made private organizations that do the job which by the Constitution was granted to the Congress.

Mr. BARKIN. Senator, two of the other members of the panel, if not all three, have commented on the fact that there was a great gap in knowledge on market power and the relationship of antitrust.

In my own paper I suggested and hoped that you would revive your proposal or bill for a system of Federal incorporation of large businesses which you sponsored in the early 1940's.

I spelled this out in the paper. I hope that the evidence which is presented here and on other similar occasions indicating that the studies of the problem find that much information is not available and the fact that we in studying the problem at the practical level know that control or review or understanding is sometimes difficult because these corporations and big business organizations are chartered by the State and the requisite information is frequently unavailable to the public, that some system such as you had proposed for Federal incorporation be offered, debated, and adopted by the Congress.

The large business aggregations control much of American economic life in the sense in which you have already presented. And we are very frequently and generally not adequately informed, both as to their conduct, their policies, and the results. It requires very searching analysis to obtain the information, and then only such data as the corporation itself is willing to release.

Nevertheless, the operation of these corporations and their behavior have great public significance and power as these hearings and your own hearings in the Senate Judiciary Committee have unfolded.

It seems, therefore, most appropriate that one immediate need for resolving this endless controversy on the meaning of power is for the Federal Government to require Federal incorporation. With Federal incorporation will obviously come a requirement for submission of data about policies and results which would enlighten us more adequately.

I also believe that the release of such information on policy and results would itself tend to have a constructive effect and influence upon the behavior of our present corporation.

So I am here pitching awfully hard to get you to see if we can't revive that very constructive proposal which you offered.

Senator O'MAHONEY. I thank you very much, Mr. Barkin. That is music to my ears, of course.

But in self-defense I ought to point out that when I filed the report of the Temporary National Economic Committee—that was in the spring of 1941—we were being dragged into World War II. The events that were taking place at that time were making us the arsenal of the nations that were resisting Hitler. And so it became impossible, because of the war, for us to give any attention to the civilian economy, which sadly needed, as it does now, a revision by intelligent leaders in all phases.

Unfortunately, when I proposed Federal incorporation, which included labor unions, may I say, as well as trade associations, the suggestion was immediately attacked upon the theory that it was intended to give the Government control over economic activity. And, of course, a great hue and cry was raised.

I never had any thought of giving the Government control. I don't believe in managerial government. And nothing in my bill even suggested managerial government.

The purpose was to establish standards to which organizations created by men would have to adhere in order to protect the public interest of the great people of the United States.

So I have been hoping that the time would come when we could get leadership to begin to comprehend the necessity of adopting such a principle.

Let it be remembered that no city in the United States can come into existence except by the approval of the State in which it exists. It must comply with the charter laws for political organizations. No State can be admitted to the Union until it adopts a constitution which the Congress approves and then passes an act of admission.

I see no reason why any great corporation should assume to itself the economic power to carry on business through every State in the Union, and through foreign nations as well, without obtaining a charter from the Federal Government in the jurisdiction of which these corporations operate.

For example, it was clearly revealed in the investigation of the Suez crisis that some of our great American corporations have hundreds of subsidiary corporations, many of which are chartered by foreign nations, as well as by the States of the Union, and none of these corporations has a charter issued by the Federal Government.

And the Congress which has the duty under the Constitution of regulating interstate and foreign commerce in the public interest, exerts none of that power, while the corporations, through their multiple subsidiaries and affiliates, agreements one with another, have established an economic government which shapes our national affairs and our foreign affairs, too.

I am glad whenever anybody raises this question. And I take advantage of it, as I have taken advantage of it today, merely for the purpose of making clear once again to this limited audience the principle that the sponsor of that legislation does not believe in Government control of the activities of individuals.

But the Government does have the constitutional duty to regulate the organizations created by men which affect this economy in an interstate and national economy.

I thank you for your attention. You are sort of a captive audience.

Mr. Barkin. Senator, may I ask whether it would be desirable from the point of view of the record to include an article to which I had referred by Professor Ross, called "Do We Have a New Industrial Fuedalism"—this is a matter relating to one of the questions which was pointed out in the outline sent us, or on which one of the panelists commented. And this represents probably one of the—this represents a very current article, currently published, dealing with this problem. It sheds much new light on it.

And if it is desirable, I will propose to you, Senator——

Senator O'MAHONEY. I think it is appropriate that that be made part of the record.

DO WE HAVE A NEW INDUSTRIAL FEUDALISM?

(By Arthur M. Ross*)

There are fashions in problems as well as hats; and when any given problem is solved, an equal and opposite problem generally emerges. The matter of labor mobility is a good case in point. A generation ago, "wasteful and destructive turnover" was seen as a primary evil. Today, it is feared that workers have become badily immobilized. While "turnover" may still be an ugly word, "mobility" has taken on a favorable connotation, something like "alkalinity"; and while "stabilization" is still a virtue, "immobilization" is a vice.

It is said that seniority systems, health and welfare plans, and negotiated pensions have chained the worker to his job; that the adaptability and flexibility of the labor force are being sacrificed; and that a new industrial feudalism is being built. The crux of the problem, it is held, is that the worker can no longer afford to quit his job.

Proponents of this view emphasize the recorded decline in quit rates since the Second World War. For example, Joseph Shister has observed that "at no time since 1929 has voluntary mobility been as high as, say, in the twenties of this century." He concedes that the low turnover rates of the depression were understandable, but expresses surprise at the subsequent failure to regain the levels of the twenties. By way of explanation he states:

"When we turn * * * to voluntary horizontal mobility (i.e., quits), we find the role of trade-unionism shifting from a negligible to a paramount influence. Seniority in promotions and layoffs has reduced the amount of voluntary mobility for reasons which have been stressed again and again. * * * The negotiated pension plans in many units will serve as another obstacle to voluntary mobility by organized workers" (22, p. 44).

Comments by Paul F. Brissenden, Ewan Clague, and Gladys L. Palmer are essentially to the same effect, and are interlaced with concern over the supposed immobilization of the work force (5, pp. 767–768) (7, pp. vii–ix) (15, pp. 114, 116).[1]

If it were true that the worker can no longer afford to quit his job, grounds for concern should indeed be voiced. First, a serious issue is raised by the image of an employer who is too benevolent. The allembracing institution which takes care of every need cannot be made to fit our traditions of self-reliance and free association. Voluntary servitude can be as degrading as the involuntary kind (13). Second, if quitting one's job were so expensive as to be unthinkable, many desirable personal readjustments would be prevented. Some people should quit their jobs to find more congenial kinds of work, more agreeable supervisors and fellow workers, and better advancement opportunities. Third, a serious economic problem would indeed be created if manpower resources were to become inflexible and immobile. In our dynamic economy, a great deal of movement between occupations, between establishments in the same industry, between industries and between geographical areas is required. The question of why workers decide to move is the subject of much research and debate (14, chs. 3, 5) (18, chs. 4, 5) (20) (19, pt. 1) and many other publications, but this much can be said: Up to the present, the American labor force has been sufficiently fluid to fill the changing needs of employers. Recall,

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*The author is professor of industrial relations at the University of California, Berkeley. He is glad to acknowledge the very substantial help of Paul Hartman who devised the measures of work opportunity and made the variance analysis and who was of assistance particularly in connection with secs. I and II. The author also wishes to acknowledge valuable suggestions from Benjamin Aaron, Irving Bernstein, J. W. Garbarino, William Goldner, Margaret S. Gordon, G. H. Hildebrand, and Van Dusen Kennedy.

[1] Compare Frank Tannenbaum's exultant conclusions in his highly romantic treatment of trade unionism as a syndicalist "counterrevolution": "The mobility of labor has been possible because the worker had no investment in the industry in which he worked. * * * The industry will now assume responsibility for providing his family with medical care, maternity insurance, sickness, old-age and retirement pensions, vacations with pay, and innumerable other services. * * * What this really means is that the worker is changing a contract terminable at will to a contract terminable only at death" (24, pp. 181–182).

Source: American Economic Review, December 1958, pp. 903–920.

for example, the vast occupational, industrial and geographical movements of personnel during the second world war, when wage rates could not be used to attract manpower because of economic controls.

Therefore, it becomes important to examine the propositions that our labor force is being immobilized by the attractions of seniority and negotiated fringe benefits. The basic conclusion of this article is that the weight of evidence is strongly to the contrary. While some of the premises of the immobilization theory are valid, they do not add up to the stated conclusion. A long-term decline in the quit rate has occurred, but not for the stipulated reasons. Most employees who quit are too recently employed to have acquired substantial seniority or pension credits; employees with more than a few years of service have always had low quit rates; and the decline in voluntary turnover has been concentrated among junior rather than senior employees. Seniority systems have served to stabilize workers by bridging over their trial-and-error period of employment rather than by tying them to their jobs. However, there are exceptions to any rule. Doubtless many individuals are influenced by pension rights, etc., when forced to make close decisions, but not so many as to alter the general picture of labor-market operation.

## I. VARIATIONS IN THE QUIT RATES, 1910–56

Movements of quit rates in American industry are shown in the last column of table 1. (Other ratios in table 1 will be used as measures of work opportunity in charts 1 and 2 below. The sources and limitations of American labor turnover statistics are discussed in app. A.) A preliminary reconnaissance of the quit rates reveals two overriding influences which produce a great deal of the variation. One is the business cycle; the other is the characteristic dislocation and readjustment of war and postwar years. The first accounts for the sharp rise in 1913 and the decline in 1914–15; the sharp decline in 1921; the sustained low level of the 1930's, with a slight recovery in 1936–37; the drop in 1949 and again in 1954. The second explains the extraordinarily high quit rates of 1917–20 and 1942–47. Cyclical variations obviously reflect changes in the opportunity to shift from one employer to another. Wartime and postwar increases reflect both propensity and opportunity. The extra workers in the labor force are not well adjusted to employment and not strongly attached to any particular establishment, and of course in wartime disorganization of work groups, family situations, and personal lives is prevalent. The resulting propensity to move creates more opportunity of itself, above and beyond that resulting from the tight labor market of wartime periods.[2]

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[2] Quit rates did not rise very much in 1951–53, during the Korean war. This is explained by the fact that the Korean war involved very little strain on the economy or the labor force. For the same reasons, the price level advanced only about 15 percent despite the absence of effective price control.

TABLE 1.—*Unemployment as percent of civilian labor force, manufacturing employment as percent of nonagricultural labor force, and average monthly quit rate in manufacturing, 1910–56*

| Year | Unemployment as percent of civilian labor force | Manufacturing employment as percent of nonagricultural labor force | Average monthly quit rate in manufacturing |
|---|---|---|---|
| 1910 | 3.3 | 39.8 | 5.1 |
| 1911 | 4.0 | 37.0 | 5.3 |
| 1912 | 4.7 | 35.8 | 5.8 |
| 1913 | 2.8 | 36.6 | 8.8 |
| 1914 | 6.7 | 34.3 | 3.3 |
| 1915 | 8.8 | 33.8 | 2.8 |
| 1916 | 4.2 | 37.8 | (1) |
| 1917 | 4.4 | 41.9 | 12.0 |
| 1918 | 1.4 | 42.9 | |
| 1919 | 2.3 | 37.9 | 5.8 |
| 1920 | 4.0 | 36.6 | 8.4 |
| 1921 | 11.9 | 27.9 | 2.2 |
| 1922 | 7.6 | 31.2 | 4.3 |
| 1923 | 3.2 | 34.4 | 6.2 |
| 1924 | 5.5 | 31.5 | 2.7 |
| 1925 | 4.0 | 32.3 | 3.1 |
| 1926 | 1.9 | 32.9 | 2.9 |
| 1927 | 4.1 | 31.2 | 2.1 |
| 1928 | 4.4 | 30.8 | 2.2 |
| 1929 | 3.2 | 32.3 | 2.7 |
| 1930 | 8.8 | 28.1 | 1.6 |
| 1931 | 15.9 | 23.3 | .9 |
| 1932 | 23.6 | 19.2 | .7 |
| 1933 | 24.9 | 20.0 | .9 |
| 1934 | 21.7 | 22.5 | .9 |
| 1935 | 20.1 | 23.8 | .9 |
| 1936 | 17.0 | 25.5 | 1.1 |
| 1937 | 14.3 | 27.6 | 1.3 |
| 1938 | 19.0 | 23.5 | .6 |
| 1939 | 17.2 | 25.3 | .8 |
| 1940 | 14.6 | 26.8 | .9 |
| 1941 | 9.9 | 31.1 | 2.0 |
| 1942 | 4.7 | 35.5 | 3.8 |
| 1943 | 1.9 | 40.3 | 5.2 |
| 1944 | 1.2 | 40.5 | 5.1 |
| 1945 | 1.9 | 37.3 | 5.0 |
| 1946 | 3.9 | 33.2 | 4.3 |
| 1947 | 3.6 | 33.5 | 3.4 |
| 1948 | 3.3 | 32.9 | 2.8 |
| 1949 | 5.4 | 30.4 | 1.5 |
| 1950 | 4.9 | 31.3 | 1.9 |
| 1951 | 2.9 | 32.7 | 2.4 |
| 1952 | 2.6 | 32.7 | 2.3 |
| 1953 | 2.5 | 33.6 | 2.3 |
| 1954 | 5.0 | 31.0 | 1.1 |
| 1955 | 4.0 | 31.4 | 1.6 |
| 1956 | 3.8 | 31.1 | 1.6 |

[1] Not available.

Sources: 1. Civilian labor force. 1910–18: Computed from S. Lebergott, "Annual Estimates of Unemployment in the United States, 1900–1954"; "The Measurement and Behavior of Unemployment," National Bureau of Economic Research, New York 1957, pp. 215, 216. 1919–28: Estimates of employment from J. P. Herring, "Labor Force, Employment and Unemployment," Seattle 1951, p. 216, plus unemployment as estimated by Lebergott, op. cit. 1929–49: U.S. Bureau of Labor Statistics, "Handbook of Labor Statistics, 1950," p. 35. 1950–56: U.S. Department of Commerce, Bureau of the Census, "Annual Report on the Labor Force," annual issues, 1950 through 1956.

2. Unemployment. Lebergott, op. cit.

3. Manufacturing employment. 1910–18: N.I.C.B. data from "Historical Statistics of the United States, 1789–1945," Bureau of the Census, Washington 1949, p. 65. 1919–56: U.S. Bureau of Labor Statistics data; from "Historical Data," in "Employment and Earnings," June 1957, vol. 3, p. 1.

4. Nonagricultural labor force. 1910–18: Computed from Lebergott's figures; Lebergott, op. cit. 1919–56: U.S. Bureau of Labor Statistics nonagricultural employment figures (from "Employment and Earnings," op. cit.), plus Lebergott's unemployment estimates.

5. Quit rates. 1910–18: Computed from P. F. Brissenden and E. Frankel, "Mobility of Labor in American Industry," Missouri Labor Review, June 1920, vol. 10, p. 48. 1919–29: Computed from Missouri Labor Review, July 1929, vol. 29, pp. 64, 65, and February 1931, vol. 32, p. 105. 1930–48: Computed from U.S. Bureau of Labor Statistics, "Handbook of Labor Statistics, 1950," p. 40. 1949–56: Missouri Labor Review, April 1957, vol. 80, p. 517.

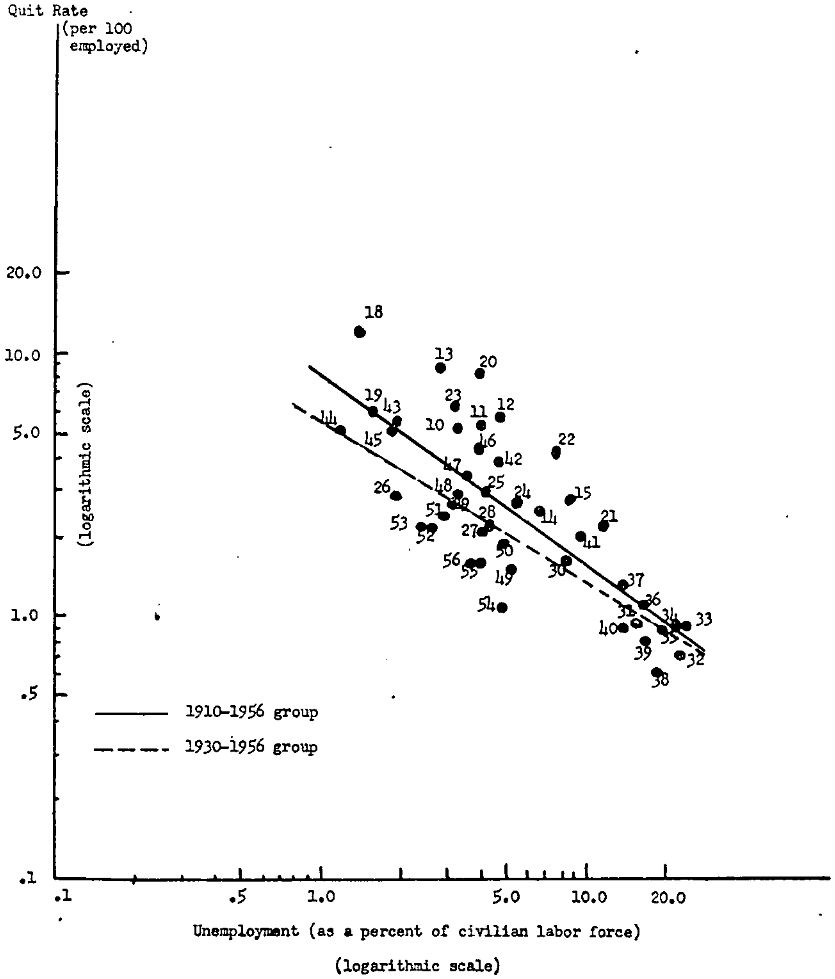


CHART 1. QUIT RATE COMPARED WITH UNEMPLOYMENT RATIO, ANNUAL AVERAGES, 1910-1956

It follows that significant conclusions about long-term movements in the quit rate cannot be drawn until cyclical variations in work opportunity have been discounted. It also follows that significant comparisons cannot be made except between periods which are relatively similar in their economic context. It proves little, for example, to show that quit rates in the 1950's have been higher than in the 1930's or lower than in the 1940's.

With some initial observations in mind, we can now examine somewhat more systematically the relationship between opportunity to move and quit rates. Alternative measures of work opportunity are incorporated in charts 1 and 2. These are two approaches to the same problem, the second being more precise. Therefore, it should not be thought that 70 percent of the variation in quit rates is explained by chart 1, and another 85 percent by chart 2.

In chart 1 the average monthly quit rate is plotted against the rate of unployment (the average number of unemployed as a percentage of the civilian labor force). Two measurements have been calculated. For 1910–56, the explained variance is 39.8 percent. Turnover data since 1930 are more reliable than in the earlier years. The corresponding figures for the 1930–56 period is 70.0 percent. In other words, 70 percent of variations in the quit rate during this period can be said to be associated with variations in the unemployment rate.

The variance analysis measures deviations from a curvilinear regression line fitted to the original data. To facilitate computations, transformations to logarithms have been made, but all resulting relationships have been retransformed to original units.

While the results of the variance analysis are of interest, further analysis is necessary to identify the longrun changes. As one would expect, the lowest unemployment ratios were encountered in wartime and immediate postwar years, and the highest in depression years. There were 21 years, however, in which unemployment ratios were more than 3 but less than 6 percent. We can discount the influence of work opportunity to a considerable extent by confining our analysis to these years.

(1) At the top of the heap we find 5 early years: 1910–12, 1920, and 1923. The average quit rate for these years was 6.2 percent.

(2) Slightly lower are 1942, 1946, 1947, and 1948, with an average quit rate of 3.8 percent. It is felt that quit rates in wartime and immediate postwar periods are affected by shortrun changes in the propensity as well as the opportunity to move. Therefore, these years should probably be excluded from the comparison.

(3) Now we encounter 5 years in the late 1920's: 1924, 1925, 1927, 1928, and 1929. The average quit rate was 2.3 percent.

(4) Finally, 5 of the more recent years are found at the bottom: 1949, 1950, 1954, 1955, and 1956. For these years the quit rate averaged 1.5 percent.

Thus, it is necessary to go back to the 1920's to find an interval which can rightly be compared with the period since 1948. Quit rates in this recent period (excluding the years of the Korean war) are indeed lower than in the middle and late 1920's. The decline amounts to about eight-tenths of a percentage point, or one-third of the total. Certainly the change is substantial enough to be noted. But this reduction, over a 30-year span, is much smaller than the one which took place during the 1920's. Then the contraction was as much as 3.9 percentage points, or almost two-thirds.

Actually the measure of work opportunity used in chart 1 is very rough. If we use a more refined alternative approach, about 85 percent of the variations in the quit rate since 1930 can be explained.

The difficulty with the ratio of unemployment is that it refers to the labor force as a whole, whereas the available quit rate data refer to manufacturing workers. There are strong reasons to believe that the manufacturing worker's opportunity to change his job is more closely related to employment conditions in manufacturing than to those in the total economy.

It makes a real difference if the measurement of work opportunity is limited to the manufacturing sector or extended throughout the entire economy. Movements of manufacturing employment and total employment have not been the same. During the 1950's, for example, manufacturing employment has been relatively constant whereas total employment has risen sharply. The same was true in the 1920's. (See table 1.)

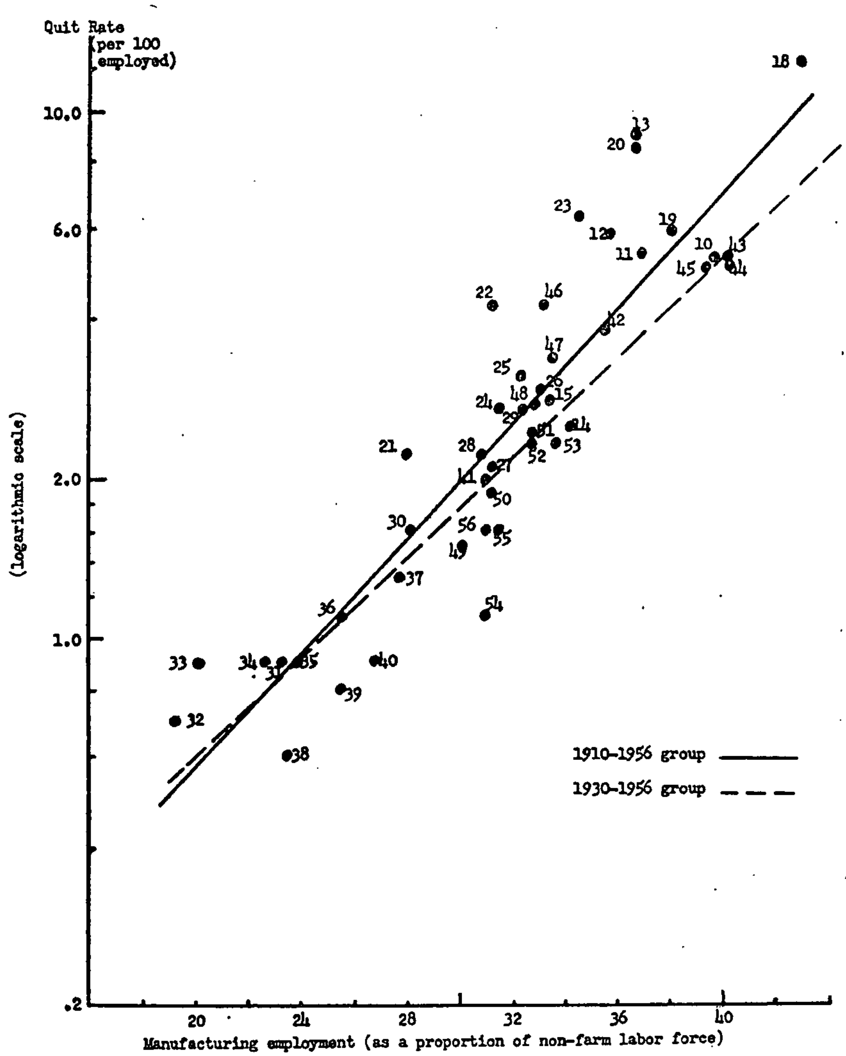


CHART 2. QUIT RATE COMPARED WITH MANUFACTURING EMPLOYMENT AS A PROPORTION OF NON-AGRICULTURAL LABOR FORCE.

It is believed that the ratio between manufacturing employment and the nonagricultural labor force represents the most satisfactory measure of the factory worker's opportunity to change jobs. In chart 2, quit rates have been plotted against this ratio. A semilogarithmic representation produces a linear relationship, but the variance analysis was made on the basis of the original data, using the same method employed in connection with chart 1. Here the explained variation is 71.3 percent for 1910–56, and 84.1 percent for 1930–56. Doubtless a more sophisticated form of statistical analysis would be desirable; but we have to do what we can with the available data. If it is conceded that quit rates are closely associated with opportunity to move, the purpose has been served.

Again the changes over time can be identified by reference to grouping the individual years. There are 12 years in which manufacturing employment equaled 35 percent or more of the nonagricultural labor force. Quit rates were extremely high in all of these years, which included 1910–13, the two World Wars, 1919–20, and 1923. Next there are 12 years in which manufacturing employment was less than 29 percent of the nonagricultural labor force. Quit rates were generally low in these years, which included 1921 and 1930–40.

There remains a middle group of 21 years, with ratios of more than 29 percent and less than 35 percent. This is not quite the same middle group as appeared in chart 1: for example, the years 1951–53 are now included, whereas 1910–12 are excluded. Within this group a very significant comparison can be made between 1924–29 and 1949–56. This comparison is significant for several reasons. The intervals are of substantial length and generally comparable in economic circumstances. Relative work opportunity, as defined in chart 2, did not vary to any large extent. The more recent interval represents the period of negotiated economic security plans.[3] The average quit rate for 1924–29 was 2.6 percent. For 1949–56 it was 1.8 percent. Once more the difference is equal to eight-tenths of a percentage point, or about a third of the total. And once again the reduction is small as compared to that which took place during the 1920's.

## II. THE DECLINE IN THE QUIT RATE IN THE 1920'S

Our findings thus far can be summarized briefly. (I) A large part of the fluctuation in quit rates is associated with variations in the opportunity to move.[4] Therefore, it is clear that even if collective bargaining provisions did affect the willingness to move, they would operate within a narrow compass. (2) A very substantial reduction in the quit rate occurred about the middle of the 1920's. (3) There has also been a smaller decline during more recent years. It remains to discuss the probable causes of these long-term changes.

Obviously the earlier phase cannot be explained by unionism, seniority, or negotiated fringe benefits. While doubtless there were many contributing causes, the critical sequence of occurrences was probably somewhat as follows:

Until the 1920's, employers had made no particular attempts to conserve manpower. Under the liberal immigration policies of the day, conservation was unnecessary. During the First World War, however, employers had a foretaste of curtailment. Then the quota system began to take effect; and by the second half of the 1920's average annual immigration was less than one-third of what it had been two decades earlier (34, p. 92). Meanwhile manpower needs were growing rapidly as industry expanded. The number of employees in manufacturing industries rose from 5,675,000 in 1904 to 7,514,000 in 1914, and 9,475,000 in 1923 (34, p. 783). There were similar increases in other activities. Thus, the demand for labor accelerated at the same time as an important source of supply was virtually eliminated. Furthermore, the occupational composition of the labor force was gradually shifting. The proportion of unskilled labor was declining; the proportion of skilled, semiskilled and white-collar workers was growing (8, p. 187). So long as the unskilled hand was replaceable, the employer suffered no great loss when the employee quit. But when the trained employee resigned, a considerable investment had to be duplicated.

It was under these circumstanes that personnel administration emerged and flourished as a specialized and systematic technique of industrial management.

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[3] 1949 was the year in which the pattern-setting health and welfare and pension plans were adopted in the steel industry, after a strike, pursuant to the recommendations of a Presidential factfinding board.

[4] Diminished opportunity to move is not the only reason why quit rates are low in depression years. Young workers with low seniority, who account for most of the voluntarily mobility (see sec. III below), are likely to be involuntary unemployed during such years.

Surfeited as we are with human relations today, we find it difficult to comprehend the shock of original discovery which employers experienced in learning that workers were human beings. For the first time, atention was turned to the influences affecting discipline, efficiency, morale, and worker adjustment in general. In otherwords, the employer decided to decasualize the whole employment relationship and to incorporate system into it.

Currently it is fashionable to assume that the central purpose of personnel administration in the 1920's was to keep the unions out. This is rewriting history to a large extent. It is true that some of the sources of the personnel administration movement are to be found in the strike wave following the First World War. For example, the Jersey Standard program initiated by the Rockefellers grew out of the strike at the Bayonne refinery; the McKenzie King program at Colorado Fuel & Iron resulted from the Ludlow massacre. But on the whole, in manufacturing industries at least, the unions were so weak in the 1920's that no special efforts were needed to keep them out. The really urgent objectives were to obtain more production from the worker, improve the condition of discipline, and especially, reduce the prodigious rate of labor turnover.[5] Exactly how this last objective was accomplished need not concern us here. Like most purposes tenaciously pursued, it had the reward of success; and if the available statistics are deserving of any belief at all, the success was considerable.

A further explanation is found in the stability of manufacturing employment during the late 1920's. Annual averages in table 1 show a narrow fluctuation between a low of 9,523,000 and a high of 9,997,000 during the 1924–28 period. As indicated above, published turnover statistics refer to manufacturing industries. When manufacturing employment expands, young people, geographical migrants, and unemployed workers are drawn in. These groups have high quit rates. When manufacturing employment levels off, the work force becomes stabilized. Average age and seniority increase. Older workers and senior workers (who tend to be the same individuals) are much less likely to quit.

### III. REDUCTION IN THE QUIT RATE IN RECENT YEARS

In addition to the signal reduction in the quit rate achieved during the 1920's, there seems to have been a smaller reduction during more recent years. The employee's desire to preserve his seniority status, retain his group insurance, and protect his pension credits is frequently invoked as the cause. It has become so costly to quit, we are told, that the worker is bound to his job by chains of benevolence.

Actually it is not very likely that these negotiated benefits have had much effect on the quit rate. Most workers who quit their jobs are young in years and low in service. They do not have enough seniority to keep them from changing jobs; they have typically not reached an age where retirement is a real element in their thinking; and they have plenty of time to accumulate work credits after coming to rest. The older worker, on the other hand, is disinclined to change employment for a good many reasons even in the absence of seniority and fringe benefits—particularly the difficulty of securing another job, the probable loss of economic status, and his settled way of life generally.

The function of voluntary turnover has been admirably described by Lloyd G. Reynolds:

> Voluntary mobility is essentially a form of job shopping by workers. * * * Workers have great difficulty in judging the attractiveness of a job by talking it over in the company's employment office. The only way to judge it accurately is to work on it a while. After a few weeks or months of work, one can tell whether the job is worth keeping. This explains why quits are most

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[5] The early textbooks and treatises in personnel management emphasized this goal. "The estimated economic loss due to turnover in the United States is placed in round numbers at $1½ billion annually. * * * The cost of training of a new employee up to the point of efficiency varies from $25 per head to $1,000" (25, p. 61).

"The cost of labor turnover is far greater than one would at first imagine. * * * In practically every instance decreased turnover has been followed by increased production and lessened cost. One concern reduced its turnover from 150 percent to 33.5 percent, and its manufacturing cost was lowered by 10 percent and its production increased by 42 percent" (2, pp. 69, 71).

See also (3, pp. 12–13) (12, pp. 197, 203, 205).

By 1929, however, it was possible to state: "The trend of labor turnover has been distinctly downward during the last 10 years, to such an extent, indeed, that the subject is no longer considered as of primary importance" (10, p. 300).

frequent during the first few months of service and diminish rapidly after that point (19, p. 22).[6]

Innumerable labor mobility studies confirm this analysis. "So universally has mobility been found to decline with advancing age that this relationship may be regarded as conclusively established" (18, p. 102). The inverse correlation between age and mobility has been demonstrated in surveys of various Philadelphia work groups in the 1920's and 1930's (16, p. 49) (11, p. 116) (17, p. 20), sample studies of employees with OASI wage credits in the 1940's (1, pp. 70–71) (4, p. 33), and most recently in Eldridge and Wolkstein's careful analysis of a sample of the entire labor force (9, p. 103).

These studies certainly throw doubt on the proposition that the moderate decline in the quit rate during recent years can be explained by seniority clauses and negotiated fringe benefits. They are not conclusive on the point, however, for the rate of turnover among older workers, although relatively low, is still considerable. The matter becomes much clearer when turnover rates and quit rates are correlated with length of service. Here the inverse relationship is much more striking. Thus, in his study of New Haven manual workers, Reynolds found that 71 percent of "voluntary changers" had less than 3 years' service in the establishment; 80 percent had less than 5 years; 94 percent had less than 10 years. (This was a predominantly nonunion group, incidentally.) Reynolds concluded that "the propensity to move declines sharply with increasing length of service; it is slight after 3 years and negligible after 10 years of work in the same plant" (19, p. 21).

This condition has prevailed as far back as labor turnover statistics have been available. As early as 1913–14, Brissenden and Frankel found that 81.3 percent of all "separations" had been on the payroll less than a year, and 89.4 percent less than 2 years. For 1917–18, the corresponding figures were 83.9 percent and 91 percent (6, p. 51) (23, pp. 54–57) (26, pp. 39–41). Thus even the enormous labor turnover prior to 1920 was concentrated almost entirely among junior employees. The most recent demonstration is found in a series of labor market studies issued in 1956. These were conducted in seven metropolitan areas, by State agencies or local universities, and were coordinated by the U.S. Bureau of Employment Security. To a considerable extent, a common format and standardized survey and statistical methods were used. The data for Minneapolis-St. Paul, Detroit, Philadelphia, and Worcester, are most comparable.[7] Although quit rates are not tabulated by age and seniority, the total separation rates are most instructive. The average monthly separation rate for all workers during the sampling period varied between 1.6 percent in Philadelphia and 3.9 percent in Minneapolis-St. Paul. Among junior employees with less than 1 year's seniority, the rate varied between 7 percent in Philadelphia and 11.8 percent in Worcester. For those with 1 to 4 years, it lay between 2 and 3 percent in all cases. For employees with 5 to 9 years of service, the rate is less than 1 percent per month in each area; and after 10 years, it becomes very low. Keeping in mind that these are total separation rates, we can be sure that quit rates are negligible indeed for workers with any substantial seniority—(28) (29) (30) (31)—appendix or supplementary table 4(c) in each.

It is true that firms with pension plans generally have lower separation and quit rates than firms without pension plans. One should be careful not to jump at conclusions, however. Firms which are likely to adopt pension plans are also likely to have lower separation rates for independent reasons. The recent Los Angeles labor market study, for example, shows that pension plans are associated with low turnover. But pension plans are also relatively more frequent in the larger firms and in nonseasonal industries (27, p. 53). It is well established that large firms tend to have low turnover rates, probably because of abundant opportunities for promotion and transfer; and the same is true of nonseasonal industries, almost by definition. In the Minneapolis-St. Paul study, the higher quit rates among firms not having pension plans virtually disappear when size of firm is held constant. In the Philadelphia study, such firms do not have higher separation or quit rates. They do in Detroit, however, even when size of firm is held constant (29) (30) (31) appendix or supplemen-

[6] The present writer has shown that the discharge is another phase of the trial-and-error process during the initial period of employment. Most discharged employees have low seniority status. See (21, pp. 29, 49).

[7] The San Francisco report is generally on a par with the four named above, except that an error in calculation seems to have crept into some of the tables.

tary table 7(a) in each. Certainly it cannot be claimed that these studies are conclusive on the point. But at the least, they are sufficient to show the danger of spurious correlations between pension plans and turnover rates.

The material analyzed thus far in this section shows that a very high proportion of labor turnover is concentrated among youthful workers, and that practically all is concentrated among short-service employees. These facts render it most unlikely that the reduction in the quit rate can be explained by the attractiveness of seniority protection, group insurance, and industrial pensions.

It is likely that several other causes are responsible for the moderate decline in the quit rate during recent years:

1. The spread of unionism. In the preunion period, the most common method of expressing dissatisfaction was to quit. Nonunion workmen have been known to strike, and sabotage and slowdowns were available expedients; but generally if the employee became unhappy enough, he could move off elsewhere. Under unionism this individualistic method of exhibiting and relieving discontent has been replaced by concerted action, which can be invoked without quitting jobs. Furthermore, many of the most obnoxious features of factory life have been removed; and although discontent is the normal condition of mankind, the American factory worker's grounds for discontent are more relative and technical than they were a generation ago. The appalling conditions which once drove men out of their jobs have largely disappeared.

2. Aging of the labor force. "Aging" means that fewer employees are going through the experimental phase of their working lives. It results from the relatively small number of young people reaching working age, and reflects the low birthrates of the 1920's and 1930's. In 1940, 14.5 percent of the civilian labor force in the United States were between 20 and 24 years of age. As countless surveys have shown, this age group accounts for a very large part of all labor turnover. By 1956, only 8.8 percent of the labor force were between 20 and 24. Another relatively young age group (25 to 34 years) declined to a somewhat smaller extent, from 25.7 percent to 22.2 percent of the labor force. Over the same period, the proportion of "mature" workers in the civilian labor force (a comfortable euphemism designating those between 45 and 64) increased steadily. It stood at 27.2 percent in 1940 and 33.0 percent in 1956.[8]

It is interesting to note that the proportion of young people in the labor force has in all probability about reached bottom. The large age generations of the 1940's will soon be ready for work. In due course of time they will be followed by the even larger generations of the 1950's. (There were 2,155,000 live births in the United States in 1935, 2,360,000 in 1940, 2,735,000 in 1945, 3,554,000 in 1950 and 4,168,000 in 1956 [34, p. 56].) These new workers will go through their own periods of trial and error, and eventually settle into their own grooves. If the present analysis is valid, it follows that quit rates in 1966 should be considerably higher than those prevalent today.

It may well be, however, that most of the new workers will not find their way into the manufacturing industries where quit rates are measured. (The reasons for this expectation are explained in the next paragraph.) Therefore it is quite possible that manufacturing industries will not participate fully in the "deaging" of the labor force and the concurrent increase in the quit rate during the 1960's.

3. Stability of manufacturing employment can be listed as a third reason why the quit rate among factory workers has recently declined, as well as explaining why it is less likely to increase during the next decade. It will be remembered that manufacturing employment remained stable from 1924 through 1928; and this fact has been cited as one explanation for the declining quit rates in the second half of the 1920's. During the present decade, the number of production workers in manufacturing has not increased since 1951. In contrast, employment in various white-collar fields such as wholesale and retail trade, finance, insurance, government, etc., has moved up sharply [34, p. 202]. Since young persons entering the labor market gravitate toward expanding areas of activity, the new entrants have been attracted into nonmanufacturing industries to a disproportionate extent. Presumably labor turnover rates have increased there, but unfortunately we have no measures. At the same time they have been depressed in manufacturing.

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[8] Sources of civilian labor force statistics: (32, pp. 1–254) (33, p. 22). Statistics on the age of distribution of manufacturing employees would be the most pertinent, since turnover data are limited to manufacturing. Unfortunately such statistics are not available.

Corroboration is found in the fact that the manufacturing labor force has "aged" considerably faster than the total labor force. This was already evident by 1950, as table 2 shows. It is believed that the disparity is considerably greater at the present time. The proportion of employees in the mobile phase of working life has become even smaller than otherwise would have been the case.

TABLE 2.—*Median age of employed workers, United States, by industry and sex, 1940 and 1950*

| | Males | | | Females | | |
|---|---|---|---|---|---|---|
| | 1940 | 1950 | Increase, years | 1940 | 1950 | Increase, years |
| All industries | 38.3 | 39.7 | 1.4 | 32.3 | 36.4 | 4.1 |
| Manufacturing industries | 36.0 | 38.4 | 2.4 | 29.8 | 34.5 | 4.7 |

Sources: U.S. Department of Commerce, Bureau of the Census, 16th Census of the United States: 1940: Population"; vol. III, "The Labor Force"; pt. I, "U.S. Summary, Washington, 1943", pp. 197, 199; and "Census of Population: 1950," vol. II, pp. 1–286, 287.

4. Effect of seniority rules. Age and length of service are intimately related. While there are no statistics on the seniority status of employees in manufacturing, undoubtedly the average factory worker has a greater length of service today than he did 10 or 15 years ago. And the quit rate almost drops out of sight for workers with more than 5 years of employment in a given establishment. Wholly aside from any effect on motivation, seniority rules have facilitated the preservation of a stable work force in the manufacturing industries. Even the short-service employee is protected against replacement by a younger worker from the outside as long as he survives his probationary period and is not discharged for cause. (This factor is particularly important in industries where seasonal layoffs are important, such as the manufacture of automobiles and ladies' garments.) Thus he is kept on the payroll to the point where he reaches a decision to "stay put," and his trial-and-error period can be said to have closed. Thereafter, the guarantee of being rehired after layoff and the protection against arbitrary discharge permit him to carry his decision into effect.[9] Although seniority rules have thus contributed indirectly to the moderate reduction of the quit rates in manufacturing during recent years, they have done so not by virtue of their attractiveness and not by tying men to their jobs, but rather by tiding them over the trial-and-error period.

Of these various causes of the moderate decline in the quit rate in recent years, the spread of unionism is probably not reversible. The "aging" of labor force on the other hand is reversible and is scheduled to be reversed. The stability of manufacturing employment as a "cause" does not have much social significance and would disappear if more extensive turnover data were available. The effect of seniority rules, finally, does not involve any diminished propensity to change jobs at a given level of seniority.

Probably a complex of sociological factors should also be included as causes. People marry early, have children quickly, buy a tract house and imbed themselves in the slough of installment debt. Then there is the prevailing mood of togetherness and the fear of disrupting the little ones by changing their schools.

All in all, little evidence can be found for the proposition that labor resources have become immobilized and a new industrial feudalism has been created because men can no longer afford to quit their jobs.

## APPENDIX A.—LABOR TURNOVER STATISTICS

There are grave difficulties in using the available time series of turnover rates for comparative purposes. While the comparisons made in the foregoing article are considered valid, the reader is entitled to a description of the series. (Sources have already been cited at the bottom of table 1.)

[9] "The propensity to change employers diminishes rapidly with increasing length of service. It is not entirely correct, however, to say that it is length of service which 'causes' a worker to remain with an employer. It is at least equally correct to regard the acquisition of years of service as the result of prior decision by the employee that the company is a good place to work" [19, p. 39]. Similarly, "Greater length of service is not an explanation of past immobility, but a description or measure of it" [18, p. 107].

For the period 1910–18, Brissenden and Frankel pieced together some large Government surveys with more fragmentary data to make a continuous series. The samples are very small except for 1913–14 and 1917–18. Aside from these 2 years, the industrial composition is not known, except that it included not only manufacturing but also nonmanufacturing industries, as well as certain activities excluded from later studies as being too seasonal. The employment base used to calculate turnover rates did not consist of actual employees. "Equivalent full-year workers" of 3,000 man-hours were used for this purpose. The aggregated rates are arithmetic means weighted by "equivalent full year" employment.

Data for 1919–29 were gathered by the Metropolitan Life Insurance Co. Again the inadequacy of the sample is evident, especially for the 1919–26 period when fewer than 160 firms of uncertain industrial and geographical composition were included. This time the employment basis is the average number of workers on the payroll, and the aggregated rates are unweighted medians.

In 1930 the Bureau of Labor Statistics inaugurated the current series of turnover statistics. The sample of firms is much larger and undoubtedly more representative than those used in the earlier series. As in the original 1910–18 studies, aggregate rates are weighted averages. Actual employment on the survey date is used for the computation of rates.

The most critical comparison, as we have noted, is between the quit rates in the late 1920's and those in the 1950's. Unfortunately the Metropolitan Life Insurance rates and the BLS rates are only roughly comparable at best. We have no information as to the industries and plants represented in the Metropolitan surveys. Use of average monthly employment to calculate percentages, rather than actual employment on the survey date, probably did not introduce any systematic bias. Median rates, used in the 1919–29 series, will certainly be different from the weighted averages used since 1930. If, as is likely, the larger firms have lower turnover rates, medians will run higher than weighted averages.

Despite these difficulties, it is believed that the statistics are good enough for the present purposes. There are several reasons for this belief. First, a primary objective of this article has been to cast doubts on certain affirmative propositions. These propositions have been made without careful study of the available statistics and certainly without access to any better ones. Second, precision is not of crucial importance. General tendencies and relationships are more significant than exact quantities. Third, although a good part of the statistical showing can properly be questioned on grounds of sampling error, etc., there are so many indications pointing in the same direction as to suggest that the argument is probably valid.

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Senator O'Mahoney. The bells indicate that there is not a quorum on the Senate floor. So, I have to leave my position at the moment.

The next meeting will be held tomorrow at 10:30 a.m., in this room.

Judge Victor R. Hansen, Assistant Attorney General, in charge of the Antitrust Division will appear to discuss antitrust policy and Employment Act objectives.

The committee will stand in recess until tomorrow at 10:30.

(Mr. Horace M. Gray subsequently submitted the following for the record:)

Supplemental Statement by Horace M. Gray

At the hearing before the Joint Committee on February 3, 1959, certain questions were raised, either in the papers or in the course of the discussion, on which I would like to comment further in order to clarify my position.

### 1. Monopoly and Economic Growth

There is a disposition in some quarters to assume, and I thought I detected overtones of this view in the panel discussion, that as a Nation we are dependent on large business corporations for future economic growth. It is these large concentrates of wealth and power, so the assumption holds, which will provide the dynamics of growth necessary for a sustained acceleration of investment, scientific research, technological development, employment, output, and purchasing power.

This roseate expectation, in my judgment, is certain to prove illusory. As I pointed out in my introductory statement, concentrated economic power, where the degree of concentration is sufficient to permit market control, will by its nature, motivation and interest practice restriction. Such restriction will retard economic growth and breed industrial stagnation. This generalization does not imply the complete absence of growth in all sectors of the economy or a total cessation of new investment and technological improvement. It does affirm, however, that in an economy dominated by private power groups the overall rate of economic growth will be very considerably less than would be the case under a general state of free competition.

Furthermore, and this is an important point frequently obscured by the aggregative approach, such growth as does occur under the aegis of private monopoly will be distorted, unbalanced and misdirected. The net result is waste of resources, inefficiency, social tensions, and disparities of such magnitude and adverse consequences as largely to nullify the beneficial effects of the limited growth in the monopolistic sectors of the economy. In short, many socially harmful things will be done while many socially desirable things will be left undone. The reason for this misdirected effort is that monopoly, being subject neither to the restraints of competition nor the direction of Government, will do only those things that enhance its power, profit or security. Social welfare and balanced economic progress are not within its purview or responsibility.

If, then, we want the maximum rate of overall economic growth of which we are capable and if we want this growth to create a balanced, free economy which maximizes welfare for all the people we must reject the counsel of those who say it can be done through concentrated private market power. That road leads to ultimate stagnation, rigidity and loss of economic freedom.

### 2. MONOPOLY AND GOVERNMENT

Much of the curent discusion of monopoly problems seems to proceed from the premise that private monopoly operates in a sort of social vacuum; that men create and maintain by purely private action, and without benefit of Government, the great concentrates of economic power which dominate our basic industries. Government, according to this view, is purely external force which appears on the scene only after monopoly has become an established fact and endeavors through antiturst procedure to restrain the exercise of monopoly power, or to break asunder what private men have put together.

It cannot be emphasized too strongly that this view is historically and factually wrong. The concept of private monopoly has long been obsolete in major American industries; it persists only as a vestigial remnant in the backwashes of our economy—in the unorganized sectors where men still seek by private conspiracy and collusion to suppress competition. In the basic industries, however, monopoly has become public monopoly; it exists by virtue of public toleration and support, not by private action alone; Government is no longer an external factor but rather an active, affirmative force without whose positive assistance monopoly on the present scale could not exist. In my introductory statement, and in the opening statements of Professor Kahn and Mr. Massell, there are listed numerous policies and actions of Government which, whether or not so intended, actually aid and abet the creation and maintenance of monopoly. It is toward these policies that the critical attention of the committee should be directed; here is the area where remedial action by the Congress is urgently needed.

It is futile to bewail the inadequacy of antitrust policy, or to dismiss it out of hand as weak, limited, and ineffective. It is dangerous folly to conclude that, since antitrust policy is a failure, nothing can be done, that monopoly is inevitable, and that we must bear the cross as best we can, hoping for some miracle of "corporate conscience" to save us from monopolistic aggression. A candid institutional appraisal of the sources and foundations of monopoly power will disclose that Government is primarily responsible. Further study of governmental policies which promote and perpetuate monopoly will reveal how reversal or monification of these policies would reduce the impact of monopoly and make our economy more competitive. Antitrust policy is bound to fail if it stands alone as the only bulwark against monopoly while Government, in other directions and by the use of other sovereign powers, is actively promoting monopoly and destroying competition. The point here is that all governmental policies, including antitrust, should be fully integrated and directed toward the common objective of eliminating monopoly and promoting free competition. If this were done with vigor, courage, and imagination then antitrust policy would be a valuable and effective weapon in our antimonopoly arsenal. Within a total institutional context favorable to competition antitrust procedure could deal effectively with private aberrations from competitive organization and practice.

### 3. MONOPOLY AND INFLATION

Monopoly is not a direct, or original, cause of inflation but, given an inflationary situation, it exaggerates and accelerates the rise of prices, and renders the stoppage of inflation more difficult than would otherwise be the case.

Government must bear the original, primary responsibility for the creation of an inflationary situation. The postwar imbalance between money purchasing power and goods stems directly from unsound governmental policies, specifically: Excessive expansion of the money supply, excessive increases in mortgage and consumer credit, overinvestment, deficit financing, monetization of the national debt, hoarding and stockpiling, exclusion of foreign goods, contrived scarcity, price fixing, subsidies, foreign aid giveaways, and wasteful military procurement. It was these shortsighted and unsound policies which created the inflationary situation—the imbalance between goods and money purchasing power—the so-called excess money demand which pushed up prices generally.

Monopolists, operating in this inflationary context, merely exploited it to their own advantage. They were strategically situated to do so because of their decisive control over output and markets. By restricting production they made the relative scarcity of goods more pronounced and the pressure of excess money demand more severe; by raising prices to meet this excess money demand, not only present but anticipated, they were able to increase profit margins and earn abnormal profits. Thus, normal monopoly profits, which they would have earned under stable prices, were greatly increased by the adventitious circumstance of inflation. There can be no doubt that their output-restricting, price-raising, profit-maximizing activities have led to sharp price increases in the monopolized sectors of the economy. These increases, in turn, have forced up prices in the more competitive sectors beyonds the level that would have obtained in the absence of monopoly pricing.

While it is incorrect, then, to say that monopoly causes inflation, it is valid to say that monopoly, operating in an inflationary situation, compounds the evil by making inflation more rapid, more extreme, and more onerous than otherwise would be the case. Moreover, the presence of monopoly in the basic industries renders the stoppage of inflation and the transition to a stable price regime extremely difficult. Strict control of production, markets, and prices enables monopoly to curtail output, and to maintain prices and profit margins in the face of stabilized or falling money demand. The burden of making the necessary adjustments in prices and returns falls with compounded severity on workers, farmers, small businessmen, competitive producers, and the social services, and on taxpayers who must provide funds for relief of the distressed. Where monopoly will not make price and profit adjustments, and Government will not or cannot compel it to do so, the burden of effecting the transition from inflationary to stable conditions falls with double severity on the community.

Realization of this certainty leads many, who despair of eliminating the evil of monopoly, to advocate perpetual inflation as the only practicable way to insure full employment in a highly monopolistic society—the only way to keep such a system going. This is a counsel of desperation. We cannot hope to cure one social evil (monopoly) by introducing another poison (inflation) into the body politic. Neither can we checkmate or outflank monopoly by continuous inflation; monopoly by virtue of its strategic power can always turn inflation to its own advantage. The alternative to monopoly is not inflation but competition. As indicated above there are many ways to attack and destroy monopoly power. We should exploit each of these to the fullest extent possible and forgo the temptation to seek an easy, but ultimately disastrous, solution by means of inflation.

In this connection a brief observation on the current view that organized labor causes inflation appears in order. This is economic nonsense; labor has no inherent, or original, power to raise prices generally. As indicated above, Government is responsible for creating the inflationary situation; it is also responsible for tolerating and promoting monopoly, which exploits the inflationary potential for its own advantage. Confronted with these twin evils—inflation and monopoly—what can organized labor do? Clearly, it cannot by its own power eradicate either; nor can it raise wages sufficiently to offset the combined adverse impact of both. The best labor can do, under such circumstances, is to struggle to keep up with rising prices. Only the strongest and most strategically placed unions can hope to keep pace; weak unions or unions in competitive industries, and all unorganized workers, find the struggle hopeless. Even the strongest unions cannot hope to succeed in the long run for ultimately inflation and monopoly together will wreck the economy and in this collapse all labor will suffer.

If any blame attaches to organized labor in this connection, it is the normal human frailty of pursuing illusions—specifically of believing that it can do business successfully with inflation and monopoly, that it can beat the game by raising wages pari passu with rising prices. Thus, while organized labor is not guilty of the original sin of causing inflation it must share, with the American people generally, the blame for tolerating governmental policies that promote both inflation and monopoly. It is high time that organized labor should bring to bear the full weight of its influence against both these social evils.

#### 4. INCREASED GOVERNMENTAL CONTROL

During the panel discussion the idea was advanced that since concentrated private power is likely to be a permanent feature of our system Government should assume general responsibility for the control and direction of the economy in order to insure realization of the goals of the Employment Act. This view has certain attractions but is fraught with grave dangers. It may well be conceded that monopoly power is socially irresponsible and cannot safely be entrusted to make decisions affecting the economic welfare of the people. It does not follow, however, that our Federal Government, as presently constituted, would be capable of making and enforcing wise and socially beneficient decisions against strongly entrenched and recalcitrant monopolies. Our experience over the past 75 years with railroad, public utility, antitrust, and other types of monopoly regulation is not reassuring on this point. Such regulation has all too frequently proven to be incompetent, ineffective, or corrupt. The regulated industries have successfully opposed and frustrated regulation, or subordinated it to their own service. In view of this record one must be sanguine indeed to believe that Government regulation in the far more difficult and complex basic industries can succeed against the opposition of powerful monopoly interests. The more likely probability is that such regulation will either succumb to the monopolists or, to escape this dilemma, will be compelled to move on to public ownership.

Since public regulation inspires little confidence and since the country is obviously not prepared for public ownership in the industrial field, and since it is technically possible to reduce monopoly power and to promote more active and viable competition, this latter course would appear best for the calculable future. A combination of free competition in the industrial area and strong governmental control over key factors, such as monetary, fiscal, investment, and social welfare policies, offers better prospects for success under present conditions than some generalized system of public control superimposed on a foundation of private monopoly.

(Whereupon, at 12:30 p.m., the committee recessed, to reconvene at 10:30 a.m., Wednesday, February 4, 1959.)

# JANUARY 1959 ECONOMIC REPORT OF THE PRESIDENT

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WEDNESDAY, FEBRUARY 4, 1959

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met at 10:30 a.m., pursuant to recess, in room 457, Senate Office Building, Hon. Paul H. Douglas presiding.

Present: Senators Douglas and O'Mahoney; Representatives Kilburn and Widnall.

Also present: Roderick H. Riley, executive director; John W. Lehman, clerk.

The CHAIRMAN. Mr. Hansen, we are very grateful that you could appear here this morning.

Let me apologize for the other members of the committee not being present. We expect them to come in shortly but I do not think that we should delay you any longer.

Again, let me say that we are glad for you to be here, to talk to you, and to discuss this general subject.

Will you please go forward with your statement.

## STATEMENT OF VICTOR R. HANSEN, ASSISTANT ATTORNEY GENERAL IN CHARGE OF THE ANTITRUST DIVISION, DEPARTMENT OF JUSTICE; ACCOMPANIED BY ROBERT BICKS, FIRST ASSISTANT TO VICTOR HANSEN

Mr. HANSEN. I appear this morning in response to your chairman's letter to the Attorney General, dated January 28, 1959. Attached to that letter was a list of four questions you wished me specifically to treat.

First, what can antitrust contribute "to attainment of the objectives of the Employment Act of 1946"?

Second, as an outgrowth of that inquiry, "How would economic growth be promoted by" the "three recommendations to strengthen antitrust policy" contained in the President's 1959 Economic Report?

Finally, merging your third and fourth queries, what role should antitrust play vis-a-vis "inflationary price movements"?

1. Antitrust and the Employment Act of 1946: At the outset, I emphasize the community of interest which I share with this committee in the achievement of the fundamental objectives of the Employment Act of 1946. The act specifically states that maximum production is to be promoted in a manner calculated to foster free competitive enterprise.

The two, indeed, in our system are closely related. The more effectively free competitive enterprise functions, the greater the opportunity for maximizing employment and the achievement of economic growth with relative price stability.

Antitrust enforcement programs are shaped by considerations of enforcement resources. Such limited resources must be devoted to striking down illegal restraints affecting those sectors of the economy which are most significant in terms of employment and production. To the extent that we are successful in such important economic sectors, we believe our contribution to the attainment of the objectives of the Employment Act of 1946 is both positive and direct.

In sum, then, the Employment Act specifies free competitive enterprise as an indispensable element of that environment in which its goals are to be achieved. And, antitrust, to repeat, is a prime form of Government action seeking to insure that free competition flourishes. Accordingly, antitrust has a real role to play in the scheme of the Employment Act.

II. The Economic Report's legislative recommendations for improving antitrust's effectiveness: However, this role can and should be stepped up. Five proposals for enhancing competition by improving our antitrust laws were transmitted to the Congress by the President in his Economic Report of January 1959.

Three of these are of particular concern to me. One deals with Federal regulation of the merger of banking institutions through the acquisition of assets.

Second is the proposal to require that advance notification be given to the antitrust enforcement agencies by firms of significant size that are engaged in interstate commerce when they propose to merge.

Third is the proposal that the Attorney General be given the power to issue civil investigative demands under which the necessary facts may be elicited when civil procedures are contemplated in antitrust cases.

These recommendations were first presented to the 84th Congress and were again presented to the 85th Congress. Comprehensive hearings were held on these proposals and they have made some legislative progress. It is our sincere hope that the 86th Congress will enact all three proposals into law.

(a) Curbs on bank mergers: The need for reasonable curbs on bank mergers stems from present section 7's failure to cover asset, as distinct from stock, acquisitions by banks. This section provides, as to stock acquisition, that it applies to all corporations "engaged in commerce."

Section 7's asset acquisition portion, in sharp contrast, covers only corporations "subject to the jurisdiction of the Federal Trade Commission."

Further, section 11 of the Clayton Act exempts banks from Federal Trade Commission jurisdiction by specifying "that authority to enforce compliance" with section 7 "is hereby vested * * * in the Federal Reserve Board where applicable to banks, banking associations, and trust companies." On the basis of these provisions the Department of Justice, as well as most other authorities, has concluded that asset acquisition by banks are not covered by section 7 as amended in 1950.

As a result, section 7 is for practical purposes useless to cope with a bank merger trend that the Chairman of the Board of Governors has indicated has been of considerable concern to the Federal Reserve Board and which the Comptroller of the Currency has also described as "fairly large."

As you are aware the Federal banking agencies have recommended amendment of the banking laws, dealing with bank mergers which would require prior approval of those agencies under standards which we consider are much less stringent than those of the Clayton Act. I will not go into the merits of the two proposals before this committee except to say that I favor an amendment of section 7 of the Clayton Act.

And such step should be taken soon. For the current decline in commercial bank competition bodes ill for our free enterprise system. Small newcomers to markets depend on banks, rather than equity markets, for financing. As the number of banks diminishes via mergers, such newcomers, it follows, have fewer and fewer sources on which to rely. Thus, that flow of new concerns on which our free enterprise system depends for vitality may be curbed by increasing bank mergers.

Now as to premerger notification: The second legislative proposal deals with premerger notification. Before mergers can be appraised, they must of course be discovered. Our experience has been that a good part of the time and effort of the staff is occupied with ferreting out, before they occur, those mergers with potential anticompetitive effects. At best, these discovery techniques are cumbersome.

The first step in the discovery procedure is to list and briefly review all mergers and acquisitions reported by such trade journals, financial newspapers, and manuals of investment, as the Wall Street Journal, the Commercial and Financial Chronicle and Standard Corporation Records. This initial investigation aims roughly to gage the economic effect of acquisitions, proposed or consummated. Should this limited review indicate an acquisition may have adverse effects on competition, a more comprehensive investigation is initiated.

If it appears that the merger may have those anticompetitive effects section 7 proscribes, we then seek from the parties involved detailed information concerning the merging companies and any affected industry.

In addition, the Department makes use of the data already in its files or data secured from other companies, Government agencies, and trade associations.

Premerger notification should substantially ease the investigative burden. No longer would it be necessary to commit a larger number of attorneys to the merger surveillance function. More important, many mergers not presently publicized in advance of consummation would be brought to our attention.

Not only will section 7's enforcement burden be eased, but premerger notification will benefit the business community. Lawyers representing merging companies have at times stated that disruption of business plans is lessened by Department action before merger consummation. Even in cases where merging companies do not choose to utilize our clearance program, some nonetheless urge that if the Department is to proceed at all, we sue before consummation.

Premerger notification, it seems clear, should systematize the process by which mergers are sifted and thus enable more prompt action if it is merited.

Further, we believe evenhanded enforcement requires notification. With that requirement, no longer would the company that seeks advance approval watch its closemouthed rival consummate a merger; and thereafter rely on the natural indisposition of an enforcement agency or a court to attempt to unscramble the omelet. Thus minimized is the element of chance discovery in any decision to sue.

Now as to civil investigative demand: The third legislative proposal we have labeled a "civil investigative demand." This proposal would enable the Department of Justice to compel production of documents by corporations, partnerships, and associations, but not individuals, during the investigative or precomplaint stage of civil proceedings.

The need for its prompt enactment seems clear. Under present law, the Department has no such power. Where criminal proceedings are contemplated, of course, grand jury process adequately enables production of both documentary and oral evidence. Where the Department proceeds with an eye to civil proceedings, however, experience shows the Antitrust Division is severely handicapped.

Some potential defendants may voluntarily grant access to their records. Where voluntary disclosure is denied by business concerns, the Government may be forced to resort to filing a complaint and then make use of discovery processes of the Federal rules to gather evidence. Effective enforcement, however, requires comprehensive investigation before—rather than after—formal proceedings have been filed.

In precomplaint merger investigations, the civil investigative demand is particularly important for section 7 has no criminal sanction. Accordingly, we cannot resort to grand jury to secure documents from companies under investigation. So it is that enactment of this civil investigative demand is vital to more effective antimerger work.

Finally, worthy of possible congressional action may be amendment of section 8 of the Clayton Act. This section presently prohibits a person, within certain limitations, from concurrently serving on the board of directors of competing corporations. Confining the proscription of the statute to interlocking directorates closes the door only part way.

An obvious loophole exists when a person may lawfully be a director of one corporation, while at the same time be an officer of another with which it competes. The proposed amendment to section 8 would bar persons from serving as officers of competitive corporations. In our continuing investigations and studies under section 8, we have found this practice sufficiently common to suggest the need that the loophole be closed.

Now as to the antitrust's role vis-a-vis inflation: I turn next to a brief discussion of the following statement taken from the Economic Report of the President on which you asked me to comment, quoting:

> Self-discipline and restraint are essential if agreements consistent with a reasonable stability of prices are to be reached within the framework of free competitive institutions on which we rely heavily for the improvement of our material welfare.

Reading this statement in context, I gather that the President is referring to collective bargaining agreements and is, in effect, urging management and labor to exercise restraint in the negotiation of such agreements in order to avoid inflationary results. This quotation, then, bears not at all on the question whether "our free competitive institutions are * * * functioning sufficiently well to create adequate market restraints."

Finally, I should like to comment on the role which I believe antitrust enforcement can play in combatting inflation. This is a matter which has absorbed my interest since early last fall when the Attorney General was asked to serve on an informal Cabinet committee to study the problems of inflation.

Specifically, we looked into two questions. First, could enforcement of the antitrust laws be used as an effective instrument of public policy in combatting inflation? And, second, if enforcement could be so utilized, how could it best be anti-inflation oriented? We concluded that while antitrust law enforcement has very definite limitations as an anti-inflation instrument, there are areas in which enforcement if coordinated with a governmentwide anti-inflation program, can be made an effective arm of that program.

Antitrust's limitations as an anti-inflation weapon stem from a number of factors. First is the insulation of significant sectors of the economy from the jurisdiction of the Federal antitrust laws because of specific congressional exemption, or exemption through the court's interpretations of the antitrust statutes.

Second, and of equal importance, is the limited resources available for antitrust enforcement. These resources are too meager to mount a broad gage enforcement program oriented toward the curbing of inflation in all sectors of the economy.

Third, antimonopoly enforcement under section 2 of the Sherman Act, in view of the structural characteristics of contemporary markets, makes protracted litigation inescapable and short-term results doubtful. Thus, section 2 enforcement cannot be expected to produce immediate effects against inflation.

Notwithstanding these limitations antitrust enforcement can and is being used to achieve prompt and effective short-term results in the easing of upward pressures on prices by attacking illegal restraints of trade which induce such inflationary effects.

Enforcement of this character can be expeditiously prosecuted under criminal and civil procedures. Effective remedies can produce immediate results in the elimination of the illegal restraints.

In this connection I should point out that the President has appointed two committees to function in the area of price stability and economic growth.

One, the Cabinet Committee on Price Stability for Economic Growth, headed by Vice President Richard M. Nixon, and the other, the Committee on Government Activities Affecting Prices and Costs, headed by Dr. Raymond J. Saulnier. It is anticipated that both of these committees will make antitrust enforcement an effective arm of such programs as they may develop in the areas of their responsibility.

And, finally, with respect to the inflationary pressures said to stem from the behavior of prices in the so-called administered price industries, we believe that the most effective approach is through vigorous enforcement of the antimerger provisions of Clayton Act, section 7. And such antimerger enforcement might well focus on the newly emerging industries.

By this approach we hope to prevent in the incipient stage the development of industrial market structures which, if not inhibited by Government action, would ultimately expand the concentrated administered price sectors of our economy.

Effective section 7 enforcement today will, in our view, bring supply, demand, and price into more normally competitive relationship in such new and growing industries of tomorrow as chemicals, plastics, and electronics. By so doing we would avoid—a decade or so from now—that pattern of undue concentration which today plagues autos and steel.

And in connection with administered price industries, I would like to mention that the Department successfully concluded its efforts to block the proposed merger of the Bethlehem Steel Corp. and the Youngstown Sheet & Tube Co. As you know, when the proposed merger was announced, we filed suit under section 7 of the Clayton Act.

On November 20 Judge Weinfeld ruled that the merger would substantially lessen competition and tend to create a monopoly in many lines of commerce in many sections of the country. He relied upon, among other things, the substantial increase in the level of economic concentration in the steel industry that would result from the merger.

In rejecting an affirmative defense that the merger would enable the companies to offer more competition to United States Steel, the court pointed out that other steel producers could with equal force argue that they should be permitted to merge in order to afford more challenging competition to United States Steel and Bethlehem, and thus the already highly concentrated steel industry would head in the direction of "triopoly."

Judge Weinfeld's opinion was the first to be rendered after trial in a suit by the Government under Clayton Act, section 7, as amended in 1950. We learned last week, with some regret that the defendants will not appeal the decision to the Supreme Court.

Now I would like to describe briefly our antitrust enforcement program for the current year.

First, we shall increasingly emphasize our merger work. Building on precedents of this past year, our merger program should expand. Proceedings under section 7 may well be an effective tool to prevent undue concentrations of economic power. As the Attorney General's National Committee To Study the Antitrust Laws has stated, a prime goal of antitrust is to "assure * * * some limitation on economic power incompatible with the maintenance of competitive conditions."

To that end, section 7 may be uniquely suited. Thus, section 7 may enable the Antitrust Division to present to the courts essential problems of industry structure in more manageable proportions than is true in section 2, Sherman Act, trials. If Bethlehem-Youngstown be a guide for trial of future antitrust issues, problems in concentrated industries may be presented to courts and decided in comparatively short periods of time.

Second, we recently moved into new phases in several major investigations under the Sherman Act. Some of these investigations had their origin some time ago. We have long been planning means for moving decisively and effectively.

This sort of investigation, I emphasize, is really the other side of the section 7 coin. By proceeding under section 7 in newly emerging industries, our aim is to prevent—or at least minimize—the sort of undue concentration that today characterizes certain industries.

Third, apart from the essentially structural problems, we shall continue our focus in those areas of the economy which most significantly influence the cost of living. Here our goal is to insure price flexibility and avoid rigged price rises. Thus, antitrust should make some contribution to the admnstration's overall effort to control inflation and insure reasonable price stability.

Finally, I touch briefly on our program in the so-called criminal area. Here our antitrust work is essentially an adjunct to the task of the Criminal Division of this Department.

Here our effort will be to mesh into this Department's overall program the antitrust laws' unique weapons. Disclosure of details at this point would be premature. Therefore, I will simply note that in the year ahead we should expect our several major investigations touching on racketeering to reach fruition.

In conclusion, let me reiterate that I am fully cognizant of the importance of the role that vigorous enforcement of the antitrust laws can and should play in the achievement of the objectives of the Employment Act of 1946. For this reason I believe we must strengthen our antitrust enforcement resources. In this regard, we have the promise of real added help in the present budget message.

The budget message requests a 10-percent increase of this Division's appropriation. The additional funds will be utilized to expand not only the staff of attorneys, but also will put in motion a program of expansion of the economic staff over the next 3 years which, in accordance with the recent recommendations of two outstanding economic consultants, will increase the size of the economic staff. This expansion will permit the introduction of more effective economic analysis in antitrust enforcement and better direct enforcement toward the objectives of the Employment Act of 1946.

The CHAIRMAN. Thank you very much.

Senator O'Mahoney, will you begin the discussion?

Senator O'MAHONEY. Judge Hansen, I am delighted to have you here. I think the Department of Justice—under your leadership, the Antitrust Division has been making considerable progress.

It is good to find the head of the Antitrust Division sponsoring the antimerger legislation which Members of Congress on the Judiciary Committee have urged in the past.

There are some sectors of this matter I would like to develop a little bit, if possible. You say that the President has appointed two Cabinet committees to struggle with inflation.

Is the Department of Justice represented on either or both of these committees?

Mr. HANSEN. I don't know whether we will be or not, but certainly I don't conceive of either of the committees functioning without asking our participation or contribution.

I don't think we are specifically named as a member of either of them, although we work closely with Dr. Saulnier. We have sat in on many of the sessions of his committee.

Senator O'MAHONEY. Your sentence which I find in your statement:

(1) The Cabinet Committee on Price Stability for Economic Growth, headed by Vice President Richard M. Nixon and the other, the Committee on Government Activities Affecting Prices and Costs, headed by Dr. Raymond J. Saulnier.

Do you know why two separate committees were set up?

Mr. HANSEN. No, sir; I do not.

Senator O'MAHONEY. Do you know of any reason why the President's Council of Economic Advisers should not have taken this matter up from the very beginning?

Mr. HANSEN. Well, as I mentioned a moment ago, I know that Dr. Saulnier has, and before him, Dr. Burns, have been going into this area and at each of the meetings the Antitrust Division was represented either by my predecessor or myself, or our first assistant, and we work very closely with them.

Senator O'MAHONEY. Do you know whether or not there is any liaison between the two Cabinet committees?

Mr. HANSEN. I don't think the one committee has actually started to function yet.

Senator O'MAHONEY. Well, do you think there is any jurisdiction that the Council of Economic Advisers does not have under the law of Congress, that is, that the President can give to either one of these committees by his own action——

Mr. HANSEN. Well, sir, I can't answer that. I haven't thought that through.

Senator O'MAHONEY. How about the staffs? Do you know whether each of these committees has been equipped with a staff yet or not?

Mr. HANSEN. I know that Dr. Saulnier has a staff.

Senator O'MAHONEY. That is probably the same staff which worked on the preparation of the President's Economic Report.

Mr. HANSEN. I assume it to be true.

Senator O'MAHONEY. Do you know anything about Vice President Nixon's staff?

Mr. HANSEN. No, sir; I do not.

Senator O'MAHONEY. It raised a question in one's mind as to why Dr. Saulnier, and the Council of Economic Advisers have not had some suggestions with respect to the inflation problem presented in the Economic Report.

For example, that which was mentioned by this committee. The very moment that we are examining the report in an attempt to make out comments, in order to bring about, if possible, a unified policy to prevent inflation and to make a better economic situation in the United States, we are advised that there are two other Cabinet Committees that begin something, and the Attorney General has not been invited, as I understand.

Mr. HANSEN. Well, there has been work going on between the various departments of Government, including the Attorney General and members of my staff on this very problem, not as an announced public committee, but certainly we have been functioning on it. We have been giving a lot of thought to it.

I know that I have had members of my staff and members of my Economic Section that have sat in with other departments of Government with the very thought of finding some possible solution to the inflation matter.

Senator O'MAHONEY. Has anything been developed as yet which does not appear in the Economic Report?

Mr. HANSEN. I cannot answer that, sir. I don't know of any.

Senator O'MAHONEY. I think possibly that members of your staff might have learned something in this.

Mr. HANSEN. Well, of course, that is the source of the information in my statement here. It is the information that has been worked out by my staff and myself as what we think might be a contribution in that direction.

Senator O'MAHONEY. Now, in your statement, you say:

> Effective section 7 enforcement today will, in our view, bring supply, demand, and price into more normally competitive relationship in such new and growing industries of tomorrow as chemicals, plastics, and electronics. By so doing we would avoid—a decade or so from now—that pattern of undue concentration which today plagues autos and steel.

Now, I gather from that, in your mind there is no doubt that we do have undue concentration both in the field of automobiles and in the field of steel?

Mr. HANSEN. That is correct, sir.

Senator O'MAHONEY. Do you think that there is any better way, then, for the antitrust laws to handle these undue concentrations? I am looking for a solution, too. As a matter of fact, for 20 years or more, I have been urging that there is one solution—if we could only get the leaders of Government and the leaders of industry to come to an agreement. And that, of course, is the judgment that all organizations, whether they be industrial organizations or labor union organizations or trade associations, which are created by men, or organized under State charters, but which deal with interstate and foreign commerce, the field that is made the exclusive jurisdiction of the Federal Government should not be required to have Federal charters.

Do you think there is a possibility of now getting some sort of a conference in that area now?

Mr. HANSEN. Well, certainly I don't think there is any problem in getting a conference. Just what results would stem from it, I would not feel qualified to predict.

Senator O'MAHONEY. You cannot predict, but do you think there is a growing understanding that in industry and in labor that the Federal Government alone is the agency which can make effective attempts to solve this problem?

Mr. HANSEN. I doubt it, sir. I think there is certainly, in the State of New York and in the State of Texas, a stepped up interest in enforcing antitrust laws, and I think there is a definite feeling that the States can play and should play a vital part in this overall problem.

I noticed in New York recently, particularly in the false advertising field and in the general antitrust field, that there has been additional appropriations given, and there has been certainly a stimulated interest.

Now, I have tried for the approxiate 3 years that I have been here to maintain as close liaison as I can with those charged with antitrust problems in intrastate matters, and as a result of it, we worked very closely, I think, with Texas and with New York.

Senator O'MAHONEY. Well, your division recently filed a civil antitrust complaint against the General Electric Co., and certain other defendants. Now, this case alleged that General Electric and Westinghouse and the Phillips Co. were conspiring to restrain foreign trade and commerce between the United States and Canada.

What has been the progress in that suit?

Mr. HANSEN. What has been the progress of it, sir?

Senator O'MAHONEY. Yes.

Mr. HANSEN. Well, it was filed, and it is not yet completely at issue. We are moving right ahead.

You might be interested, Senator, that much of the information that gave rise to the filing of that case was discovered in our discovery and investigation of the RCA case which we disposed of recently, and we are moving right ahead with it, sir.

Senator O'MAHONEY. Did it not develop in your investigation that in Canada there are subsidiaries of the American companies?

Mr. HANSEN. Well, there is no question about that. That is true. They operate through their subsidiaries, both General Electric and Westinghouse, and they have for many years.

Senator O'MAHONEY. What I was leading up to in these questions was the obvious fact that General Electric and Westinghouse, American corporations, have created subsidiary corporations in Canada, and the Canadian Government is not at all happy that these proceedings have been filed.

Mr. HANSEN. It has been brought to my attention, sir.

Senator O'MAHONEY. And obviously, these huge companies, chartered by States and not by the Federal Government, are affecting the international relations of the United States.

Do you not think that this in itself is a factor of such great importance that the leadership in the executive branch and the legislative branch, and the ledership in industry, ought to be persuaded that the time has come to try to join together and work out an economic constitution that would prevent the development of these problems, these suits which sometimes take a very long while to settle?

Mr. HANSEN. It is a real problem, sir. There has been a lot of study made on it.

Now, it is not only the Westinghouse-General Electric case, but also Swiss watch cases, our oil cartel cases in which we have this problem, and it is a difficult one.

Senator O'MAHONEY. Now, the Department of Justice is against the cartels, is it not?

Mr. HANSEN. There is no question about it, sir.

Senator O'MAHONEY. There is no question about that at all?

Mr. HANSEN. There is no question.

Senator O'MAHONEY. And yet, the cartels operate with American-chartered companies right in the middle of it.

Mr. HANSEN. That is right.

Senator O'MAHONEY. And in Europe they operate, do they not?

Mr. HANSEN. I think that is true and that makes our problem extremely difficult.

Senator O'MAHONEY. I am hopeful that since the President has created two Cabinet committees and already has the Department of Justice, then it might be possible for all three of these organizations to cooperate with this committee—the Joint Economic Committee—which was appointed by virtue of the Employment Act of 1946 for the express purpose of working out these problems.

Mr. HANSEN. Well, I have no apprehension concerning cooperation. I am sure there will be cooperation. I can certainly pledge cooperation as far as the Department of Justic is concerned, the Antitrust Division.

Mr. O'MAHONEY. That sounds very encouraging to me.

Mr. Chairman, there is a bill on the floor of the Senate. Perhaps while a quorum is being held, you might like to ask some questions.

The CHAIRMAN. Mr. Kilburn.

Representative KILBURN. In your statement about the Economic Report's leigslative recommendations for improving antitrust's effectiveness on page 2, would this affect small banks?

Mr. HANSEN. No, sir; not unless we get the other legislation. We have also asked for a legislation that would give jurisdiction to the Department of Justice in the mergers of banks where assets are acquired. We have jurisdiction now where stock is acquired.

Representative KILBURN. Well, it would not affect the little country banks, would it?

Mr. HANSEN. No, sir, if both are little banks.

Representative KILBURN. There would not be any antitrust action as long as it was in the public interest, would it, provided that there was competition?

Mr. HANSEN. I think that is right, unless in a section of the country there is a tendency toward a monopoly or a substantial reduction in competition. If any two banks, or for that matter any two corporations, are going to merge, they certainly would have to themselves acquire the information that we want before they could decide to merge. We do not think it is any burden.

Representative KILBURN. Of course, the present regulation seems to me is rather adequate on the small country banks that are merging into the Federal Reserve.

Mr. HANSEN. I don't think there is a real problem in the small banks, sir.

Representative KILBURN. Now, one other question.

What is the Department doing, if anything, to prevent monopolies in labor unions?

Mr. HANSEN. Well, the law exempts labor unions in activities concerning working conditions, wages, and hours, and so forth.

We have no jurisdiction to prevent a monopoly in labor unions.

We have a number of labor cases in antitrust. The minute that the union, for example, enters into a conspiracy with some segment of industry they are subject to the antitrust laws. We just recently received a consent decree in a case where the union and employer had agreed that the cement "gun" could be used only by union workers or by groups that were union, and could not be used by nonunion contractors.

In that case, the consent decree eliminated the restraint.

There are other areas, and they particularly are where labor unions conspire with employers or with other segments of industry, but as far as preventing a monopoly in unions, we have no jurisdiction.

Representative KILBURN. I should think another gage would be whether or not it is in the public interest.

Mr. HANSEN. That is right. I think that is very true.

Representative KILBURN. Would you favor appropriate legislation to prevent industrywide collectivewide bargaining?

Mr. HANSEN. I don't feel qualified to answer that question. I want to study it. You say collective bargaining. Are you asking me whether or not we think it is illegal? For example, the automobile industry, should they join together and collectively bargain with the unions——

Representative KILBURN. Well, I would think that it might be against the public interest if the end result was a pricing arrangement with corporations involved.

Mr. HANSEN. Well, there are special exceptions in the Taft-Hartley Act. The unions are not subject to the antitrust laws except when there is a conspiracy with an outside group.

Representative KILBURN. I do not know too much about it, but it seems to me that they should be under the law just the same as anyone else.

Mr. HANSEN. Of course, that is a problem for Congress.

Representative KILBURN. I know it. That is all. Thank you.

Senator DOUGLAS. Mr. Widnall.

Representative WIDNALL. No questions.

Senator O'MAHONEY. Mr. Chairman, may I ask another question?

Senator DOUGLAS. Yes.

Senator O'MAHONEY. I overlooked this because I did not want to hold the floor altogether.

I refer to your statement that there is undue concentration in automobiles. Does the Department of Justice have any plan in mind now with respect to the concentration in either of these fields, autos or steel?

Mr. HANSEN. Yes, sir; I feel that it would be premature for me to discuss it.

Senator O'MAHONEY. I see. Well, you can discuss perhaps the bill that was introduced on Monday in the Senate. Senator Kefauver introduced one and I introduced one.

Mr. HANSEN. That is on financing?

Senator O'MAHONEY. To break up finance companies, to separate them from the big automobile companies.

Mr. HANSEN. I noticed immediately following that, that the rate of interest of GMAC went up a half a percent.

Senator O'MAHONEY. Are you suggesting that we are causing inflation by introducing remedial legislation?

Mr. HANSEN. Well, I think that the effect of that increase would make it easier for the other finance companies to get the business, because one of the things that GMAC has been able to do is get money cheaper than the others, and it has caused the other finance companies considerable problems.

Senator O'MAHONEY. Of course, both of these bills will go to the Department of Justic for report and no doubt you will have to have conferences about the measures, and I will not try to anticipate your decision.

I do hope that there will be an early report on the two measures.

Now, one of these measures, the measure introduced by Senator Kefauver, not only deals with the separation of finance companies in the motor manufacturing business, but also deals with the insurance that is carried on by these companies and it deals in a criminal way.

The bill that I introduced is purely civil in its approach and has nothing to do with insurance, but it does include the field of the manufacturer of earth-moving machinery.

My theory was that there can be undue concentration in the automobile industry, such as has been described by leaders in the Department of Justice, and has reduced the number of competing firms from 9 or 10 a few years ago to 3 big ones today.

I think you, yourself, in one of your public statements, referred to that.

The investigations which we have held in the past on General Motors seem to indicate that the financing company thereof, the General Motors Acceptance Corp., is such a powerful weapon that it does drive competition out of the field or is a great aid to General Motors in spreading its control.

So it has become, in fact, the largest industrial corporation in the world.

If there is undue concentration, may I ask you whether you see any reason why we should not try to divest these companies from the financing field?

Mr. HANSEN. I would like very much, if you have no objection, to study your bill and make our report on it.

To be perfectly frank with you, I can't say that I disagree with what you have said. There may be other aspects of it that I do not presently think of.

Senator O'MAHONEY. Well, the Department of Justice prevented the Bethlehem-Youngstown merger.

Mr. HANSEN. That is correct.

Senator O'MAHONEY. Merely on the sole consideration that it was an effort to create a monopoly; that it would strengthen concentration in the field of steel. You proceeded with that case and you proceeded successfully, as you say in your statement here.

In principal, is there any difference between what the Department of Justice did there in the Bethlehem-Youngstown case and what is suggested in the present bill?

Mr. HANSEN. It depends on how far you go. There we had two steel companies merging.

We are talking now about a situation of having an automobile manufacturer going into a field of banking or financing.

Senator O'MAHONEY. Which is utterly separate and apart.

Mr. HANSEN. That is correct.

Senator O'MAHONEY. From the manufacture of automobiles.

Mr. HANSEN. That is correct. There are some different problems.

I agree with you, sir, that there is no question in my mind that GMAC is a great benefit to General Motors Corp. in stimulating its sales, and I am also convinced that the benefit that General Motors derives from its finance company must be in the minds of Ford when they desired to go into the finance business.

Senator O'MAHONEY. I rather feel that Ford feels it is being driven the way of other automobile competitors unless it gets a finance company of its own.

Mr. HANSEN. I think they have made that statement publicly, if I recall correctly.

Representative KILBURN. Will the gentleman yield?

Senator O'MAHONEY. Yes.

Representative KILBURN. Does your bill provide that GMAC shall be divested from General Motors Corp.?

Senator O'MAHONEY. Oh, yes. It would separate them all. It would make it illegal for a motor vehicle manufacturer to operate a financing institution.

Representatitve KILBURN. I am glad to hear that.

Senator O'MAHONEY. What I was seeking to do was lay it on the public line so it would be realized by the leaders of the motor industry that there does come a time when there can be too much concentration.

Mr. HANSEN. I remember your predecessor, Judge Barnes, was so concerned with this problem that he, in public interviews, published, suggested that the Department of Justice might think of bringing suit against General Motors to cause the divesture of some of its divisions, for example, manufacturing different types of cars.

At that time, when I was asked to comment on what he had said, I remarked that I thought it would be much better for the Department of Justice to move either in an antitrust case and sue for the divesture of GMAC. That was a very confusing procedure that had taken place in previous years.

Mr. HANSEN. We are very carefully studying that problem, Senator, and I am convinced that all major finance companies other than GMAC are going to be favorably inclined toward your bill.

Senator O'MAHONEY. I was reading a little note here that was sent up to me, and it has to do with George Romney of American Motors Corp.

Mr. HANSEN. I read his statement.

Senator O'MAHONEY. He has stated that industrial concentration, and not inflation, is our biggest problem. The author of this question wants to know what I think of it. I will turn it over to you and ask you what you think of it.

Mr. HANSEN. I read his statement, Senator. He wants to divest or split up General Motors. He seems to feel that it is essential.

Senator O'MAHONEY. Well, is there any question about the fact that General Motors, Ford, and Chrysler now manufacture about 90 percent of all the automobiles?

Mr. HANSEN. Certainly, the overwhelming majority are manufactured by those three corporations. European cars are making some inroad and certainly Rambler has done pretty well.

Senator O'MAHONEY. That is the undue concentration.

Mr. HANSEN. Yes, sir.

Senator O'MAHONEY. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Widnall.

Representative WIDNALL. Mr. Hansen, the question by Senator O'Mahoney made me think back to the aluminum industry and the fact that instead of one company we eventually had two other leaders—Reynolds and Kaiser. Has the consumer actually benefited by that?

Mr. HANSEN. I would certainly think so. I noticed the other day that Kaiser has risen to third position in aluminum production, which I think is certainly a healthy situation.

Representative WIDNALL. Is that an indication that the prices are better as far as the consumer is concerned? It seems to me that they all price at about the same level.

Mr. HANSEN. I would have to make a study of that, sir; I have not. I was very much interested in the fact that apparently entry into the aluminum industry is possible.

Representative WIDNALL. Well, with regard to Senator O'Mahoney's bill, GMAC has actually been financing a lower cost to the consumer than the other finance groups.

Mr. HANSEN. In addition to that, they are able to get money much cheaper than other finance companies can, which gives them a decided advantage over any other finance company, and obviously could make more money at a lesser rate of interest than the other finance companies.

Representative WIDNALL. Actually, if this bill passes, the consumer is liable to pay a half percent more in order to finance his car.

Mr. HANSEN. I don't feel qualified to answer that. I couldn't predict what the result would be.

Normally, if it is equal competition, there ought to be a reasonable price.

Representative WIDNALL. Well, I know we are always talking in Congress how the consumer is hurt by an increase in interest rate, and if this tends to increase interest rates to the consumer, I am interested. I want to keep it down.

Mr. HANSEN. I had in mind that very problem when Senator O'Mahoney asked me to express an opinion on the bill.

Now, the mere fact that you are going to have to weigh the sales of prices paid for the automobile with the interest paid, and so forth, I don't know. I can't tell you how the consumer is going to come out on that.

That, I would like to study.

Representative WIDNALL. Thank you.

The CHAIRMAN. I am just going to suggest that Senater O'Mahoney's bill might decrease the price of the cars because it would result in greater competition among the manufacturers of cars.

Mr. HANSEN. Well, that is what I had in mind. You are going to have to balance it.

The CHAIRMAN. Mr. Hansen, I am very pleased that the Department of Justice has made the legislative recommendations that they have, and I understand you sent bills up to the Hill to carry out these recommendations.

Mr. HANSEN. All except the one on the amendment of section 8 which hasn't gone up yet.

The CHAIRMAN. It will be shortly introduced and I want to compliment the Department of Justice. This is something which Senator O'Mahoney, Senator Kefauver, Congressman Celler and myself have been urging for many years, not always with the full cooperation of the administration. In fact, I might say, very seldom with the coöperation of the administration.

We are very glad that your proposal has passed the Bureau of the Budget and therefore we presume comes with the endorsement of the President.

Mr. HANSEN. We hope our increase in budget is accepted in the same fashion.

The CHAIRMAN. May I ask this question: Do you think 10 percent is enough, a 10-percent increase?

Mr. HANSEN. I think it is for this reason: Antitrust is a highly specialized field and I don't think we can absorb more than 10 percent in this year efficiently and effectively.

The CHAIRMAN. Now, the proposal in section 7 covering industrial mergers where you have the acquisition of assets as well as stocks has been urged by the Senator from Illinois many times in the past and has always met with the opposition of the Comptroller of the Currency, as I remember, and the Federal Reserve Board.

Now, does the fact that this comes from the Bureau of the Budget, presumably with the endorsement of the administration, mean that the objections of the Treasury have been eliminated?

Mr. HANSEN. No, sir; the Budget has permitted both of us to prepare arguments. We have done it for a couple of years.

The CHAIRMAN. In other words, the split within the administration continues about section 7?

Mr. HANSEN. And I assume it probably will.

The CHAIRMAN. May I say very strongly that I am on your side in this battle and I appreciate that you have sent it up.

Now, we have had a large number of mergers and projected mergers in New York City. Would it be probing too deeply if I asked whether these mergers had taken place in the form of an acquisition of assets rather than an acquisition of stock?

Mr. HANSEN. Practically all of the bank mergers have been by acquisition of assets.

We have an allied problem in some of the regulated industries too. El Paso Natural Gas Co. In that case they decided to go by stock acquisition to avoid the Federal Power Commission, and then we jumped on them and now they are seeking Federal Power approval of a merger of assets.

The CHAIRMAN. Have you had a chance to go into the proposed merger of the Guaranty Trust and the Morgan Bank?

Mr. HANSEN. We are making a study of it.

The CHAIRMAN. Does that involve the acquisition of assets rather than the acquisition of stock?

Mr. HANSEN. It isn't exactly clear, sir. We haven't completed our study on it.

The CHAIRMAN. If it were an acquisition of stock, you would have jurisdiction?

Mr. HANSEN. Yes, sir.

The CHAIRMAN. If it is pure acquisition of assets, you, at present, do not have jurisdiction?

Mr. HANSEN. We do not have jurisdiction. Mr. Bicks just called my attention to the fact that we were talking about section 7. I don't think we would be barred under section 2 of the Sherman Act. We might there, and that frankly is one thing we are looking into.

The CHAIRMAN. Will you describe that?

Mr. HANSEN. That is the monopolization section of the Sherman Act, and the test under section 2 is much more difficult; the hurdle is much more difficult for the Government in section 2 than it is in section 7.

The CHAIRMAN. In what way?

Mr. HANSEN. Well, under section 7 you can catch it in incipiency for one, and second, if it tends to create a monopoly, or substantially reduces competition, it is an easier burden to meet. As a matter of fact, if you recall, the General Motors case was decided by the Supreme Court under section 7 rather than section 2. We had originally proceeded both ways. We felt it was a proper section 2 case. Yet, the Court simply decided it under section 7, which is an easier test.

The CHAIRMAN. I am not sure this is a proper question, and if not, please do not answer it. Have you contemplated taking action against the proposed merger of Guaranty Trust and the Morgan Bank?

Mr. HANSEN. Yes, sir. We have contemplated the possibility, and that is the reason for our study.

Now, whether we will come up with enough to justify it or not, I can't answer.

The CHAIRMAN. Is it your impression that the Federal Reserve Board has been very lax or been lax in the question of mergers?

Mr. HANSEN. No, sir; I think they look at it from a different viewpoint than we do.

They put great weight, and I think justifiably so, on the fact that they must be conscious of the financial stability of it and even though it might cut down competition, they weigh more heavily on the fact that it makes for greater security and for a sounder financial stability.

The CHAIRMAN. Well, if I might criticize an absent body, I have found them singularly unresponsive to the argument that they should be concerned with the general affairs of banking monopolies as well as our financial security.

Mr. HANSEN. That has been our difference of opinion. I too have urged that, but I can't be critical for they will be giving due consideration to the soundness of the financial structure.

The CHAIRMAN. I have been disappointed. Now, the question of premerger notification, does that recommendation come to us with the endorsement of all Government agencies?

Mr. HANSEN. Yes, sir.

The CHAIRMAN. There is no opposition within the administration?

Mr. HANSEN. None whatever, and I checked last Monday to be certain that there hadn't developed any, and there is no opposition to any of the matters that are presented here for amendment of the antitrust laws in this Economic Report.

The CHAIRMAN. I want to congratulate you.

Mr. HANSEN. I want to modify that, except the one we have talked about on the banking situation.

The CHAIRMAN. Yes. Go ahead.

Mr. HANSEN. I said there is no opposition as presented here except this banking one.

The CHAIRMAN. May I raise this question—I think we have all noticed for many years the way in which the directors and managers of huge industries which are either monopolies or oligopolies, will sit on the boards of banks. We have also noticed the way in which the leading officials of banks and investment companies will sit on these boards of the huge industrial concerns, so that there is a mutual interdependent penetration. I have wondered as to the degree the investment markets of the country actually protected the existing industrial giants because the investment bankers sit on the boards of the industrial giants and have influenced the degree to which respective industries could raise capital. Basically my suspicion has been that it has been very difficult for a new-competitive enterprise to get the capital and cash, because financial institutions, as well as the huge oligopolies, and monopolies are so close together.

Mr. HANSEN. It would certainly be a temptation on the part of a director of a large lending institution to decline a loan to his competitor. By that I mean the industrial corporation, and not a bank competitor.

The CHAIRMAN. Do you think there should be some legislation on this or not?

Mr. HANSEN. I haven't thought that through, sir.

Senator O'MAHONEY. I think it is one of the subjects that we must think through pretty promptly.

I might say this, Mr. Chairman, that I fear that the greatest danger that this Government now faces, with its principle of freedom of economics for the people, which constitutes the reality of this Nation, it does not come from the Soviet theory that concentrated managerial government directs, in an authoritarian way, the economy which is trying to crush the United States.

Khrushchev has openly announced that his purpose, by 1970, is to be able to outproduce the United States. Because they have an authoritarian, political, and economic government, they can concentrate, and they are concentrating.

We have that testimony from Government sources in the United States. We have it from Allen Dulles, for example.

Now, on the other hand, in the United States, as you have stated this morning, there is undue concentration in at least two fields—autos and steel.

Now, that means concentration of economic power in the hands of the few individuals who have made themselves in economic government.

The Constitution of the United States has made this Government a political and an economical Government, but we are losing our economic powers to the leaders of the concentrated industry, and if we don't overcome that by education of industrial leaders, and pretty soon, I fear that we will have great difficulty in preventing the Communist economic war from being very disastrous to our Nation and our people.

The CHAIRMAN. If I may continue, on recommendation (c), I am not quite certain whether this boils down to giving the Attorney General power of subpena in an antitrust case or not.

Mr. HANSEN. If you note, in my statement, I said this is not as to individuals. This is as to corporations.

The CHAIRMAN. That is the only extent?

Mr. HANSEN. It isn't testimony—it is the production of documents and is related to a subpena duces tecum—the duces tecum part.

The CHAIRMAN. Well, thank you very much, Mr. Hansen.

Tomorrow, the witness will be Secretary of the Treasury Robert B. Anderson. In the afternoon we will have the critique of Mr. Anderson's recommendation.

The committee will stand in recess until tomorrow at 10 o'clock.

(Whereupon, at 11:40 a.m., the committee recessed, to reconvene at 10 a.m., Thursday, February 5, 1959.)

# JANUARY 1959 ECONOMIC REPORT OF THE PRESIDENT

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THURSDAY, FEBRUARY 5, 1959

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met at 10:10 a.m., pursuant to recess, in room 457, Senate Office Building, Hon. Paul H. Douglas presiding.

Present: Senators Douglas, O'Mahoney, Bush, and Javits; Representatives Patman, Bolling, Boggs, Reuss, and Kilburn.

Also present: Roderick H. Riley, executive director; John W. Lehman, clerk.

The CHAIRMAN. The committee will be in order. If you are ready, Mr. Secretary, you may proceed.

## STATEMENT OF HON. ROBERT B. ANDERSON, SECRETARY OF THE TREASURY; ACCOMPANIED BY W. T. HEFFELFINGER, FISCAL ASSISTANT SECRETARY; HENRY WALLICH, ASSISTANT TO THE SECRETARY; CHARLES J. GABLE, JR., ASSISTANT TO THE SECRETARY; AND ROBERT P. MAYO, CHIEF, DEBT ANALYSIS STAFF

Secretary ANDERSON. I welcome the opportunity to appear before your committee and to discuss the Government's fiscal outlook and some of its implications for the Nation's economy.

First, I should like to discuss the budget for the fiscal year 1960. We estimate total receipts of $77.1 billion. Of this total, $40.7 billion is expected to come from individual income taxes, and $21.4 billion from corporation income taxes. The assumptions for the calendar year 1959 underlying these figures are $374 billion for personal income, and $47 billion for corporate profits.

These income assumptions were arrived at after careful studies and consultations utilizing all data and judgment available both inside and outside the Government. The increases they represent imply a continued vigorous recovery, but at a slightly lesser rate than we experienced after the 1954 recession.

Somewhat larger revenue gains, too, were attained in moving out of the recession of 1954, if we adjust the timing of corporate tax payments for comparability. The personal income figure of $374 billion compares with a rate for December 1958 of $359 billion and the corporate profits assumption of $47 billion for 1959 compares with a rate for the fourth quarter of 1958 of $44 billion.

I present these estimates with the full realization that the revenue results for fiscal 1959 will turn out to be substantially less than we originally estimated.

I believe, however, that our assumptions for fiscal 1960 are sound and will turn out much closer to the mark. They are within the range of calculations made by private estimators, and I understand that similar figures have also been mentioned by some of the experts that have testified before your committee.

Let us now look at our present situation in a broader perspective. We are well along in the recovery from a recession which is now substantially contributing to the largest peacetime deficit in our history—$12.9 billion at present estimates. Of this deficit, about half will result from a shortfall in revenues. The remaining half is the result of increases in expenditures over original budgetary estimates.

The drop in revenues in fiscal 1959 is the direct result of the recession. The increases in expenditures reflects for the most part increases that came about automatically or through actions not primarily related to the recession. Among these are the higher cost of the agricultural program because of larger crops, the Federal Government pay increases, higher defense expenditures, and the proposed subscription to the International Monetary Fund. Some $2 billion of spending, chiefly FNMA mortgage purchases, the extension of unemployment benefits, and direct housing loans by the Veterans' Administration, represent actions designed to combat the recession.

What conclusions seem to follow from this experience? First, it seems to me that the economy has once more demonstrated remarkable resilience and resistance to recession. This is indicated by the fact that personal income declined very little, and that the recovery set in very quickly. I attribute this good performance to the inherent qualities of our economy, to the confidence and good sense maintained by our people, and to the automatic stabilizers that have become a part of the economy.

Second, I am concerned with the size of the deficit that the recession in large part produced and with its continuation in a period of growing prosperity. A deficit of this magnitude, unless quickly corrected, can produce serious inflationary pressures in the longer run, even though in the short run these pressures are held in check by excess plant capacity and other factors. The extended unemployment benefits proved timely, but the economy turned around before several of the others could have their full budget effect. Meanwhile these expenditures will continue as we move closer to increased prosperity.

Third, the decision by the administration and the Congress to avoid a major tax cut last spring has been justified by events. Had we resorted to a tax cut we would not have had this demonstration of the economy's inherent recuperative powers. We would have helped develop a philosophy that tax relief was necessary to pull us out of the downturn.

Also, a tax cut would have increased our present deficit and our public debt, and with them the danger of inflationary pressures in the future.

I fear, however, that price pressures may eventually revive, if we do not finally close the budget gap. I sincerely believe that a nation as rich and productive as ours must, in times of prosperity, at least pay its way. We can afford to do all that is necessary, and much that is desirable, and pay for it. But we should not reach for everything at the same time. Even a rich country can get into trouble if it keeps spending beyond what it pays for currently.

Some people seem to feel that to be for meeting current expenses from current revenues means to be "against" or "negative." Let us not be misled. The fact of the matter is there is almost nothing which is more positive and more important to be for than fiscal soundness. This is an essential condition of our economic health, without which we can have neither adequate military security nor the adequate provision of other needed governmental services. Meeting our expenses currently and all that that means in the way of fiscal soundness and a healthy economy is a highly positive objective which deserves the support of everyone.

Growth requires capital formation, through saving and investment. As a consequence, we should meet our expenditures out of current revenues in prosperous times. A Federal deficit financed outside the banks tends to absorb resources that could otherwise go into private capital formation. A deficit during prosperity, which is financed through the banks, in itself, of course, brings inflationary consequences.

A current deficit and the fear of future deficits can keep people from saving because of possible loss of these savings to inflation. If we ever reach the point where people believe that to speculate is safe but to save is to gamble then we are indeed in trouble.

If rising prices which will follow from continued deficits cut into saving habits, the result will be further to diminish the supply of capital for economic growth. We cannot indefinitely expect people to continue their saving if they expect prices to go on rising indefinitely. Our habits of saving, our financial institutions, our monetary system, must not be jeopardized.

Our needs for capital will increase as our labor force begins to expand more rapidly in the early sixties. This expanding labor force, the result of the high birth rate of the forties, will give a powerful impetus to the economy. But if job opportunities are to be found, with a rising degree of productivity, investment in plant and equipment will have to advance correspondingly.

Finally, orderly finances in our country are a key to maintaining the strength of the free world, and our role in it. Our prestige in the world is not enhanced if we fail to practice what we preach. The world watches us very closely. On my trip to and from New Delhi, for the annual meetings of the International Bank and Monetary Funds, I was impressed to discover how well informed foreign officials are about even the details of our budget.

But more than prestige is at stake here. If we run continuing large deficits in prosperity and so almost inevitably drive up prices, we may price ourselves out of world markets. Aside from the losses that this will mean to us, how are we to discharge our worldwide responsibilities if our international economic position weakens?

Because we are for sustainable and healthy growth, because we are for increasing job opportunities, because we look to the long run and a possibly long period of world tension, we must be for the maintenance of orderly finances and a stable dollar. I believe that the time to face this issue is now. Americans have faith in their money. That faith is justified. Confidence, if shaken, is hard to reestablish. That is why we must keep our expenditures under control, and the budget in hand.

Your committee has asked me to deal with certain questions. I would now like to turn to the first three of these. With your permission, I shall then ask Mr. Charles Gable, who assists Under Secretary Baird and myself in debt management matters to discuss with you the fourth question, relating to the management of the public debt.

Question 1: "What would you regard as the proper division of labor between tax policy and monetary policy as instruments of economic stabilization during the coming year?"

Answer: The first consideration of tax policy is, of course, to keep intact the system by which the U.S. Government raises its revenues to finance the Government service that the Nation requires.

Tax policy and monetary policy should continue to work closely to foster economic health with stability of prices as our economy grows.

After a deficit of $12.9 billion expected for fiscal year 1959, the President's budget proposes a budget balance for the fiscal year 1960. For quite a few months ahead, the net effect of fiscal policy will still be to stimulate the economy. As prosperity advances, so will our revenues until the deficit is eliminated at a high level of economic activity if spending is under control.

At the income levels projected in the budget, the tax system is expected to produce revenues approximately equal to proposed expenditures in fiscal 1960. If we achieve our objectives there will be no need, consequently, for an increase in taxes.

By eliminating the deficit, tax policy will greatly ease the task of monetary policy. If we fail to keep 1960 expenditures within income, we contribute to inflationary pressures and complicate the problems of monetary management. Tax policy will render additional assistance to monetary policy by avoiding further permanent borrowing by the Treasury in the market. This will also facilitate the Treasury's own job of handling the public debt.

Question 2: "Is the present structure of the Federal tax system adequate in light of the Nation's economic growth and stability requirements? If not, what changes would you recommend?"

Answer: I believe that any tax structure can always be improved. By that I do not mean to say that we cannot live with our present taxes. We certainly can. If new imperative revenue needs should arise, we could live with higher taxes than the present. Ours is the most productive economy in the world and I do not believe that it would be crushed by its tax burdens, if we are reasonable.

We must constantly evaluate in terms of continuing economic growth both elements of tax reform and, when proper, tax reduction. While these are closely related, they are not necessarily identical.

The Treasury has been studying and continues to study various improvements in the tax system and in tax administration. In this we are cooperating, and shall continue to cooperate, with the appropriate committees of Congress.

Many of the adjustments under review are of a technical character. Their application depends in many cases on the resolution of administrative difficulties.

It depends further on future business conditions and other factors that cannot now be foreseen. As this is a continuing study both in the Treasury and the committees of the Congress, it would be premature to attempt any detailed discussion.

The committee questions deal also with the relation of taxes to the stability of the economy. I take it that this refers principally to the cushioning effect that declining tax collections can have during a recession.

Illustrative of this effect, of course, is the sharp decline in collection of corporate taxes growing out of the recent recession. It also focuses our attention on the fact that deficits may well continue after the economy has moved up and is advancing toward full prosperity. This sort of complex problem deserves, and will have, our continuing study.

The high degree of resilience which our economy has just demonstrated seems to suggest that we should be cautious and analytical in our evaluations and flexible enough, if some future downturn should require it, to be willing to use whatever instrument seems most appropriate to the occasion. In this connection, some advance planning is proper so that the right decisions can be appropriately taken when we are confronted with cyclical movements in our economy.

Question 3: "Under what circumstances can we reduce Federal taxes? What are the prospects for realizing these circumstances?"

Answer: The circumstances and prospects of tax reduction would first depend very much on future expenditures and the maintenance of our economic growth. Economic growth can be expected to raise our revenues but it will produce no surplus if we do not control expenditures. Unless we spend wisely we will have trouble taking care of such new requirements as may prove really essential.

Next, tax reduction must be weighed against debt reduction out of surplus. I believe that in years of prosperity we should endeavor to achieve some debt reduction. This policy commends itself as an act of fiscal soundness. It would ease the task of monetary policy and the management of the public debt.

Circumstances for a tax reduction would depend further upon the degree to which we can succeed in avoiding inflation. At times of inflationary pressures we should aim at some budget surplus.

I would not now want to prescribe a precise formula or to try to predict a precise time when tax reduction might properly be considered. I have tried to point out the varying factors which would influence our judgment at the time when such a judgment seems to be appropriate.

I will now ask Mr. Gable to answer your fourth and final question.

Senator DOUGLAS. Mr. Gable, you may now proceed with your statement. I would appreciate it if you would summarize it in 5 minutes or so, and submit the full statement for the record.

## SUMMARY STATEMENT OF CHARLES J. GABLE, JR., ASSISTANT TO THE SECRETARY OF THE TREASURY ON DEBT MANAGEMENT

Mr. GABLE. Mr. Chairman, problems of debt management are always changing. While we have basic principles of approach we do not apply rigid rules. The economy is constantly changing and our policies change in accordance with that.

We have an extremely large debt woven into every section of the economy today.

The debt has been increasing last year, and at the end of the year was $283 billion.

This compares with a level of $281 billion in December of 1955; and $259½ billion in December 1946.

Only in 2 years, since 1952, have there been any reductions in the debt. That was in 1956 and 1957 to the extent of $6 billion whereas last year alone, the debt increased $8 billion.

The job of adding that $8 billion to the debt required us to come to the market many times, six times, in fact, to raise new cash of $17 billion, plus additional money raised through additional weekly bill offerings.

The total financing job last year—total issues put out—was $69 billion, which was a new high in the postwar years. The year can be divided into two halves—the first part of 1958, and the second part. During the first part, we were able to accomplish some debt extension. During the last half of the year, because of unsettled market conditions, we were restricted to issuing very short term securities.

Despite the fact that we added $8 billion to the debt last year, there was a reduction of $3 billion in the amount of the marketable debt becoming due in one year. The job of Treasury financing last year was made somewhat more difficult by the fact that the Government investment accounts were no longer accumulating securities. In fact, they were running in the red which meant the Treasury had to come to the market to raise those additional funds.

As I have indicated, during the first half of 1958, during the atmosphere of recession, with rising bond prices and falling interest rates, there were fewer market problems as far as the issuance of securities by the Treasury was concerned.

To complement monetary policy, we directed our holdings primarily at commercial banks, as was evidenced by the fact that the debt held by the banks rose by $5.8 billion in the first half of the year, even though the total debt was rising only by $1.4 billion.

With the exception of series E and H savings bonds, all types of nonbank investors liquidated securities in the first half of the year.

In the second half of the year, it was an entirely different story. With the economy entering a period of vigorous recovery, two-thirds of the $6.6 billion increase in the public debt was absorbed by investors outside of the commercial banks thereby lessening somewhat the potential inflationary impact of our deficit financing.

The Treasury would have preferred to have done a larger part of its financing outside of commercial banks during the second half of the year by placing more bonds in the hands of the longer term savers, rather than with corporations, who are interested primarily only in the shorter term securities which is the next thing to cash.

The problem that we have been faced with in attracting long-term savers has been pointed out here, going back to 1952, and the figures indicate that there has been a disinvestment on the part, not only of individuals, but also of the savings institutions.

We think that this is a very significant fact.

We are continuing to study that to see how we may be able to attract the longer term savers who have longer range objectives in holding the debt on a more permanent basis.

A discussion of the environment in which we issued our securities last year would not be complete without some reference to the market action that occurred in connection with our June financing period.

The Treasury was aware that during the early part of the year there was a substantial speculative interest in the market.

As we approached the June financing we felt that there was no question that there was a large amount of speculative interest in a possible long-term bond offering.

Unfortunately, there was no way of measuring the amount of speculation from the data and figures that were available, but, because we were conscious of the problem we, instead of including the issuance of a long-term bond in the refunding, purposely issued it for cash so that we could limit the amount and also require substantial down payments, and also allocate the securities to investors on a perferred allotment basis.

Those steps were successful, and we felt that the long-term 3¼ bond was well placed. What we didn't anticipate, however, was the fact that these speculators who had financed their holdings of maturing securities on a very thin margin would rush into the 2⅝s offered as part of the exchange, which was an intermediate bond directed primarily at the commercial banking system, and it only had approximately 7 years to run.

In fact, they did. Prior to the issuance of the 2⅝s, our best estimate and the best estimates of the people we consulted would be that the Treasury might be able to get out 3, or possibly as high as 4 billion dollars of 2⅝s.

In fact, we were advised by some that if we really wanted to do some debt extension, we should consider putting out a 2¾ rather than the 2⅝s to attract more funds in the area.

The speculators, instead of selling immediately because our long bond was a cash offering, switched into the 2⅝s, so that over $7 billion of that issue was put out.

We still feel that had market conditions remained favorable, with interest rates relatively stable that had continued for some months, that amount could have been digested by the market.

Unfortunately at that time, from the standpoint of the offering, there were press articles to the effect that the Federal Reserve might change its policy. Several news reports indicated that business recovery was in prospect, and of course, that was the basic thing that caused a turn in the rate structure.

The change in the business outlook caused it.

Now, these speculators, having financed themselves on a very thin margin, got scared and started to dump, causing a very unsettled and very unsatisfactory market condition in Government securities.

It is something that, in the public interest, should not be permitted to occur again. The Treasury is giving a great deal of thought and consideration to that. We are consulting with other groups, such as the Federal Reserve and groups in the money market, as to ways of preventing undue speculation. A certain amount of speculation in underwriting is necessary, as you know, in selling marketable securities, but excessive speculation is undesirable.

What we are trying to do is prevent undue speculation of the type that occurred last June. In the first place, we have every reason to believe that we will be able to develop additional data which would allow us to measure more accurately the amount of Government securities that are being carried at a particular time so it would reflect an increase in speculation.

Secondly, we also feel that some of the financing techniques that are used in the money market, and I am referring particularly to repurchase agreements, while basically sound and necessary, have been abused and that should not be permitted again. We are hopeful that that situation can and will be corrected.

We have done a lot of educational work because many of the lenders, even though they suffered no loss, unwittingly made credit available to speculators. In many cases these were corporations and banks outside of the money centers.

The large banks in the money centers and the legitimate Government dealers, were not involved in a significant way in causing this extension of credit, the excess, to the speculators.

The third area, of course, is our own marketing methods, and as I have indicated we did issue the long-term bond for cash, and I think as a matter of general practice in the future, it may be necessary in most cases for the Treasury to issue long-term bonds for cash where it can control the amount and where significant downpayments can be required and where the Treasury can control allotments.

I would also like to make the point that while this speculation was a discredit, nevertheless, we in the Treasury feel that the general market level of rates today would be about where it is had the speculation not occurred.

There is also another factor that contributed to this market decline and the unsettlement which has continued for many months and has only recently stabilized so that the Treasury might again issue a long-term bond, which we did in conjunction with our January cash financing. That is the fact that when the economy turned around and the investment market was aware of the fact that the Treasury still had to finance such a large deficit, an inflationary psychology developed. Fears that the deficit might have to be financed through the banking system caused a psychological impact on the market that was very great.

It caused bond prices to recede and it caused stock prices to rise very sharply. I think that we have to keep in mind that market psychology is very important, and the market relates that always to the fiscal position. If in a period of high activity the Treasury has to finance a deficit, investors are worried about the inflationary implications.

Senator DOUGLAS. Thank you very much, Mr. Gable.

(Mr. Gable's prepared statement, which was summarized above at the chairman's request, is presented herewith in full.)

STATEMENT BY CHARLES J. GABLE, JR., ASSISTANT TO THE SECRETARY OF THE TREASURY ON MANAGEMENT OF THE PUBLIC DEBT, BEFORE THE JOINT ECONOMIC COMMITTEE, FEBRUARY 5, 1959

I would like to review with you this morning some of the current problems which the Treasury faces in its debt management program. These are not problems which can be solved by applying a rigid set of rules. There are certain basic principles which we always try to follow, but the very fact that the economic environment and the market atmosphere in which the Treasury operates is constantly changing means that our approach to debt management must always be flexible.

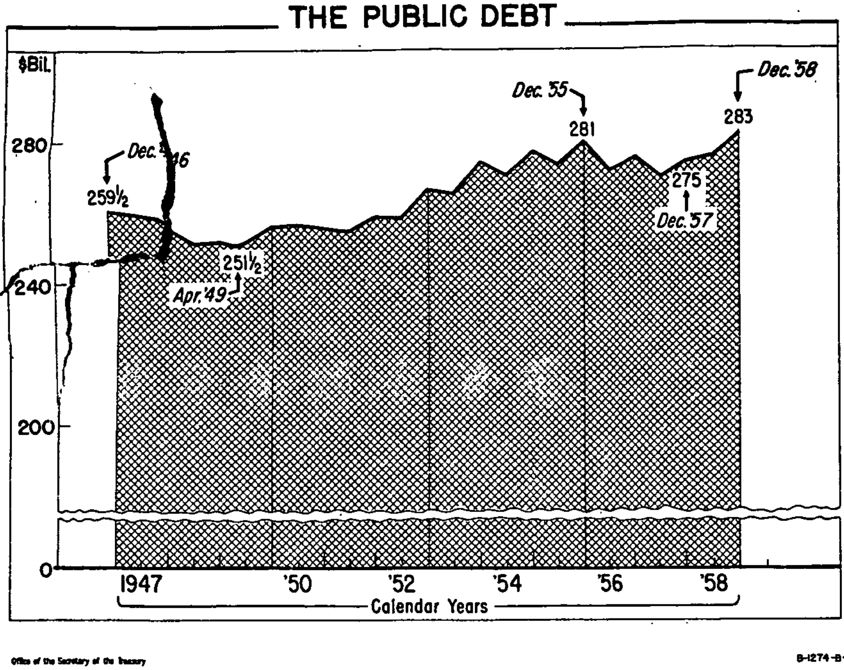
The impact of changing circumstances on debt management policies was clearly illustrated by our experience in the calendar year 1958.

The past year was a year in which the debt was growing again and as you will note from chart 1, the debt at the end of December 1958 amounted to $283 billion.

This is a large debt any way you look at it and one which is woven into the asset structure of every major class of investor in the country. In the savings bond program alone an estimated 40 million individuals own bonds and about 8 million are buying bonds currently through payroll savings plans.

The $283 billion public debt at the end of December represents an amount equal to 63 percent of the total gross national product. It is an amount equal to more than $1,600 for each man, woman, and child in America. Not only is the U.S. Government the largest single debtor in the country, it accounts for one-third of the total debt owed by all individuals, all corporations and all levels of government in the Nation.

CHART 1




After some reduction in debt early in the postwar period the public debt grew steadily again under the burden of heavy defense requirements and the Korean war, reaching a peak of $281 billion on December 31, 1955. During the calendar years 1956 and 1957, under the impact of 2 years of budget surpluses, the debt was reduced to $275 billion. That $6 billion reduction has been completely erased, however, by deficit financing in the calendar year 1958, which increased the debt by $8 billion to a new high of $283 billion. This was the largest increase in the public debt for any year in the postwar period.

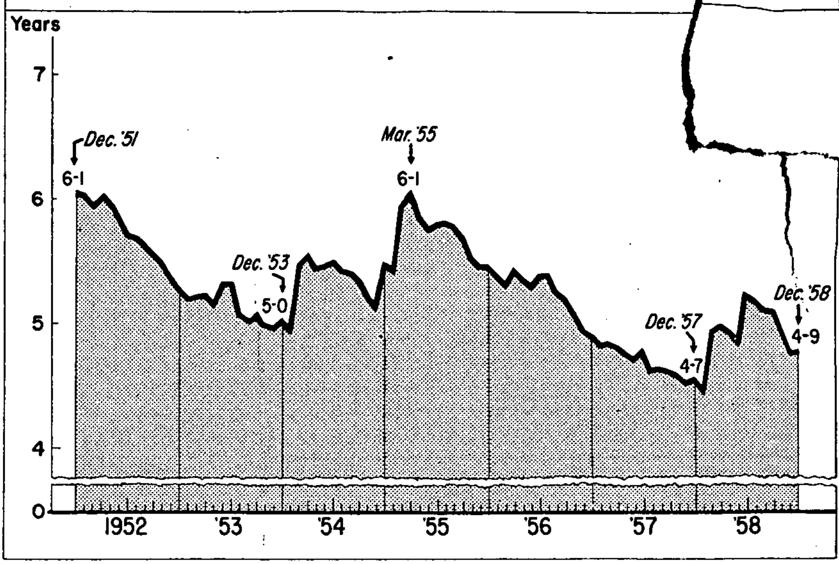
The job of adding a net amount of $8 billion to the debt in as sound a manner as possible last year required the Treasury to go to the market six times during the year to raise new cash of $17 billion, plus $2 billion more cash raised through additions to weekly bill offerings. This large amount of new cash borrowing was needed not only to cover the deficit but also to cover the retirement of other securities growing mainly out of marketable maturities paid off in cash and the redemption of the wartime F and G savings bonds which are now maturing. At the same time the Treasury issued $50 billion of new securities in exchange for maturing issues ($28½ billion publicly held and $21½ billion held by Federal Reserve banks and Government investment accounts) so that the total of $69 billion new marketable securities issued during the year reached a new postwar high.

As part of this $69 billion job the Treasury issued $2.9 billion of long-term bonds and $16.7 billion of intermediate-term notes and bonds running from 4 years to 8½ years to maturity. As a result, the average length of the marketable debt was increased by 2 months during the year—from 4 years and 7 months to 4 years and 9 months. This was done despite the inability of the Treasury to extend any debt beyond 2½ years to maturity in the unsettled market environment which characterized the last half of 1958. The slight lengthening of the debt last year was in contrast to declines of approximately 6 months each in the average length of the debt during the 2 preceding years and, as shown in chart 2, brought the average back almost to the level of 5 years ago when the long postwar decline in the average length of the debt came to an end.

CHART 2

AVERAGE LENGTH OF THE MARKETABLE DEBT

(Callable Bonds to Maturity Date)*




*Partially tax-exempt bonds to earliest call date.

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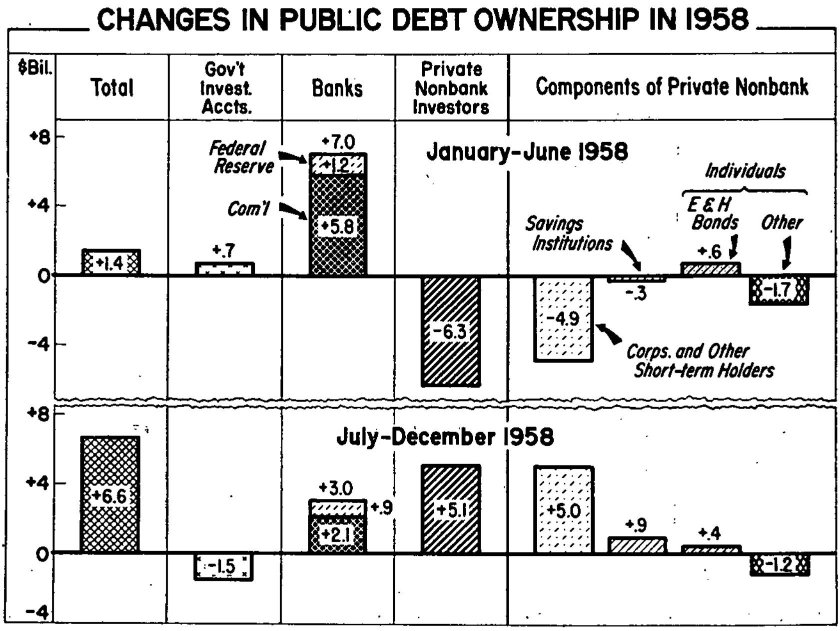
Despite the fact that there was an $8 billion increase in the total debt in 1958, there was a reduction of $3 billion in the amount of marketable debt becoming due within one year. Five years ago the under-one-year debt stood at $80 billion. One year ago it was $75½ billion. It is now $72½ billion, of which $51 billion is held by the public and $21½ billion held by Federal Reserve banks and Government investment accounts.

The job of Treasury financing in 1958 was made somewhat more difficult by the fact that Government investment accounts, which had provided a market for approximately $2 billion a year for Government securities on average during the postwar period as a whole, showed a decline of $0.8 billion in their investments. This was true because of the excess of expenditures over receipts in the unemployment trust fund, the Federal old-age and survivors insurance trust fund and the highway trust fund.

Treasury financing in the first half of 1958 was conducted in the atmosphere of recession, with rising bond prices, falling interest rates, and monetary ease. In this atmosphere it was appropriate that Treasury offerings were designed primarily to appeal to commercial banks, as debt management sought to complement monetary policy in its endeavor to increase the money supply and to better assure the availability of adequate credit for economic recovery. As a result commercial bank holdings of the debt rose by $5.8 billion in the first half of the year, even though the total debt was rising by only $1.4 billion.

With the exception of series E and H savings bonds held mostly by small savers, all types of nonbank investors liquidated Government securities in the first half of the year, with most of the liquidation being accounted for by nonfinancial corporations at a time when their profits were shrinking and their tax liabilities were at a low point. Even the sale by the Treasury of $2.9 billion of new long-term bonds during the first half of the year did not result in a net increase in the holdings of Government securities by individuals and savings institutions since the bonds were paid for, in effect, by selling shorter maturities to banks.

CHART 3

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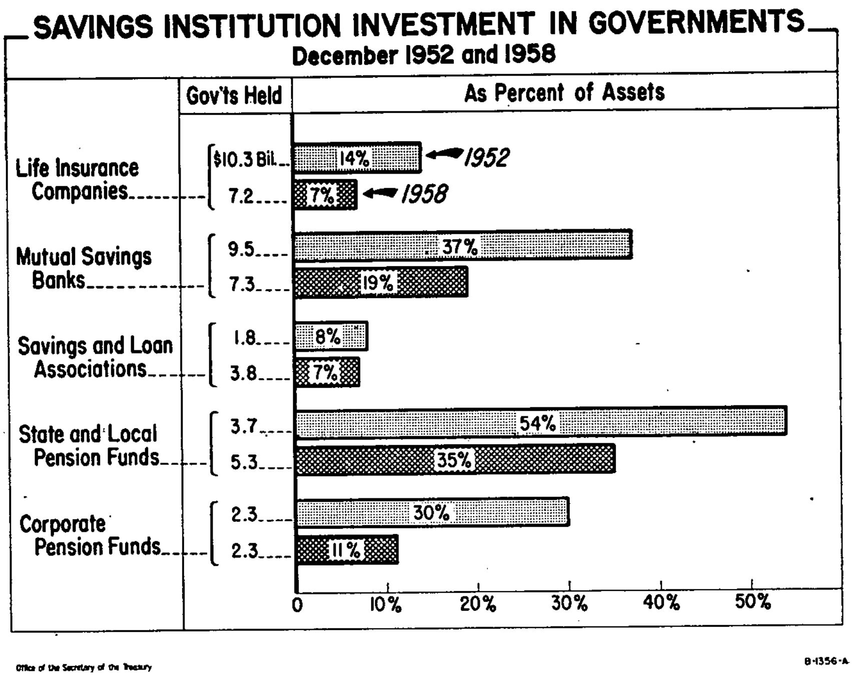
In the second half of the year, with the economy entering into a period of vigorous economic recovery, two-thirds of the $6.6 billion increase in the public debt was absorbed by investors outside of commercial banks thereby lessening somewhat the inflationary impact of Federal deficit financing at a time when other demands for funds were rising and monetary policy sought properly to temper the rise in money supply. Furthermore, all of the increase in bank holdings was outside of the larger financial centers.

The Treasury would have preferred, however, that a larger part of its financing outside of the banks during the second half of the calendar year had been through longer term savers—such as individuals and savings institutions—rather than through nonfinancial corporations. In the latter case investment in Government securities is typically in the shortest term obligations available and is only one step away from an increase in money supply. On the other hand, longer term securities are purchased by savers with more permanent investment goals in mind.

The fact that savings institutions did add somewhat to their holdings of Government securities in the second half of 1958, reversing earlier trends, is an encouraging sign, however. Individuals added further to their E and H savings bond holdings in July–December 1958, but again reduced their holdings of the larger investor type F and G savings bonds and their holdings of marketable securities during the second half of 1958.

The persistence of the postwar trend of savings institutions away from Government securities is highlighted by the fact that the four major groups of savings institutions—insurance companies, mutual savings banks, savings and loan associations and pension funds—have reduced their holdings of Government securities from $27½ billion in December 1952 to $26 billion in December 1958. This was done at a time when the assets of these institutions were growing by approximately $100 billion.

CHART 4



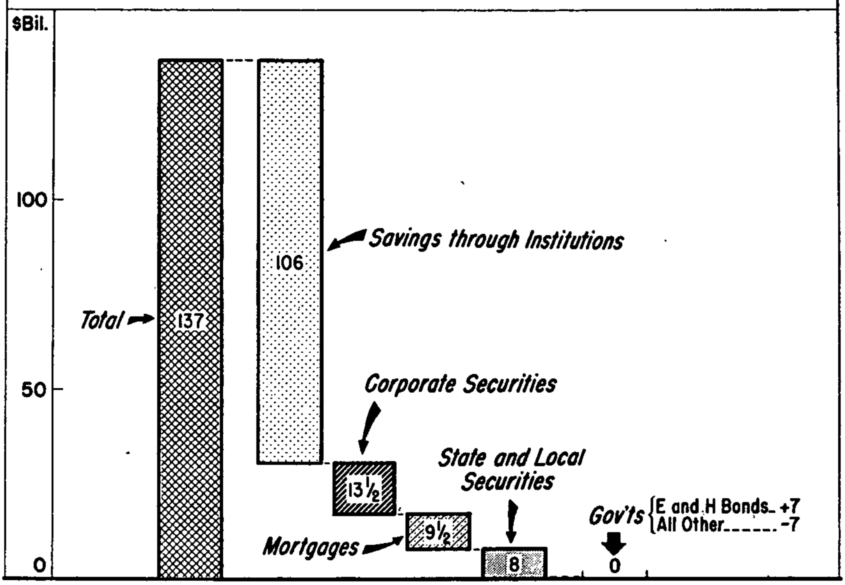

As is shown in charge 4, therefore, the proportion of assets of each of these types of institutions invested in Government securities has shown in most cases a substantial decline during the last 6 years. Even in the case of rapidly expanding savings and loan associations, which have been building up reserves in the form of Government securities, their percentage of assets invested in Governments has declined slightly.

An analysis of individuals' savings during the last 6 years shows rather clearly that no individuals savings found their way into Government securities on net balance during these years, despite substantial increases in E and H bonds. During the past 6 years individuals had new savings of $137 billion available for investment either through savings institutions or directly in securities and mortgages. Of this total $106 billion was placed directly in savings institutions, and as has been already indicated in chart 4 no part of this flow of savings on net balance reached the Government securities market.

Moreover, as chart 5 shows, none of the remaining individual's savings was invested directly in U.S. Government obligations either. An increase of $7 billion in E and H bond holdings was completely offset by a decline in holding of other Government securities. In effect, then, all of the funds available for direct investment during these 6 years went into corporate securities, into mortgages, or into State and local government issues. In the latter case, of course, the Treasury is up against a particularly difficult debt management problem in trying to make its securities attractive to individuals who have the opportunity of buying tax-exempt State and municipal offerings.

CHART 5

INDIVIDUALS' SAVINGS SINCE 1952

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A satisfactory solution to the problem of making Government securities attractive to savings-type investors is not easy to find. The Treasury is, however, exploring all possible ways of encouraging greater participation in Government security ownership by these purchasers.

A discussion of the environment in which Treasury financing took place in 1958 would not be complete without reference to the rather dramatic changes in the market environment in which the Treasury had to do its financing. With interest rates declining and bond prices rising early in the year the Treasury had little difficulty selling securities which were priced very close to the market at the time they were issued. Subsequent market rises resulting from investor anticipation of continuing recession and monetary ease made each new security look quite attractive soon after issuance. As a result, particularly with regard to the 2⅝ percent 7-year bond which was offered in June, there was an increased amount of speculative activity in new Government issues on the assumption of a continuation of these trends.

The June intermediate-term bond was put out as one part of an optional offering in exchange for maturing securities and was subscribed for in an amount of more than $7 billion—considerably in excess of what had been expected by either the financial community or by the Treasury. This large amount presumably could have been properly digested by the market, however, if the trends of recent months had continued. But improvement in business news, plus rumors in the financial community as to a possible reversal in monetary policy, resulted in a sharp turnaround in the bond market. As a result many speculative buyers who had financed their purchases on little or no margin were forced to liquidate them. The resulting disturbance was very unsettling to the entire market.

It is clear in retrospect that the reversal in bond prices reflected a legitimate change in investor expectations as economic recovery set in. Furthermore, there is no reason to believe that speculation had more than a temporary effect in depressing bond prices. But it is true, nevertheless, that the abruptness of the change in the market was accentuated by excessive speculation.

A recurrence of such activity should be prevented. The general public should be better protected against such excesses. Furthermore, dealers in Government securities under such conditions are unable to perform their vital functions of maintaining an orderly and active market for Government securities. The Treasury is at present studying this problem and consultations are underway with the Federal Reserve System and with various other groups in the financial markets to see what steps can be taken to restrain undue speculation without at the same time hampering legitimate dealer operations.

Two more factors during the summer added further to an unsettled Government bond market. The first of these was the temporary shock of the coup d'etat in Iraq. The second was more fundamental—the growing realization on the part of investors throughout the country that the Federal Government was faced with its largest postwar deficit, a factor which was obviously very important in the development of an inflationary psychology during the fall despite the continued stability of commodity prices. As a result largely of this psychology, a buoyant stock market hit new high and bond prices—for corporates and municipals as well as for Governments—hit new lows, thus adding to the cost of borrowing for business and for all levels of government.

The Treasury's market financing job in 1959 should be smaller in dollar volume than in 1958—both in terms of refunding and new cash issuance. Nevertheless the 1959 financing schedule is very heavy. We have already raised over $4 billion in new cash in January through the issuance of $0.9 billion of 21-year bonds, $2.7 billion of 16-month notes, and $0.6 billion of additional Treasury bills, bringing the debt up to $286 billion by the end of January. Although the entire deficit for fiscal 1959 has been financed and the debt is expected to fall by June 30, the Treasury will nevertheless need additional cash borrowing amounting to an even larger amount than that raised in January between now and the end of the fiscal year to cover retirements of securities coming due. We also will need an amount which we are not yet prepared to estimate to cover the heavy seasonal deficit in July–December 1959 which will occur even with a balanced budget for the fiscal year 1960 as a whole.

The refunding job this year consists not only of a weekly amount of $2 billion or so of Treasury bills which have to be rolled over, but also $15 billion of maturities in February, $4½ billion in May, $13½ billion in August, and $9 billion in November. The February refunding, the largest of the year, was announced last Thursday and we have offered holders of the maturing securities a choice between a new 3¾-percent certificate maturing February 15, 1960, or a 4-percent note maturing 3 years from now, both priced at par. The books on this exchange offering closed last night and we expect to announce preliminary results tomorrow afternoon.

Sometime before the end of the present fiscal year, the Treasury will ask for new legislation on the debt limit. We are now operating under a temporary debt ceiling of $288 billion. That temporary ceiling will expire on June 30, 1959, at which time the ceiling will revert to the permanent debt limit of $283 billion. With a $285 billion public debt now estimated for June 30 an increase in the permanent debt limit to that amount seems indicated, depending, of course, on the final outcome of the fiscal 1959 budget picture. In addition temporary financing needs will require a substantial increase in the public debt—and in the temporary debt limit—during July–December 1959, even though with a balanced budget this would represent financing which could be repaid during January–June 1960.

The environment in which the Treasury's 1959 financing program will take place will, of course, depend on a great many factors. Perhaps the two most important relate to the progress of the Nation's economic growth and the way in which the Federal Government's fiscal programs are handled.

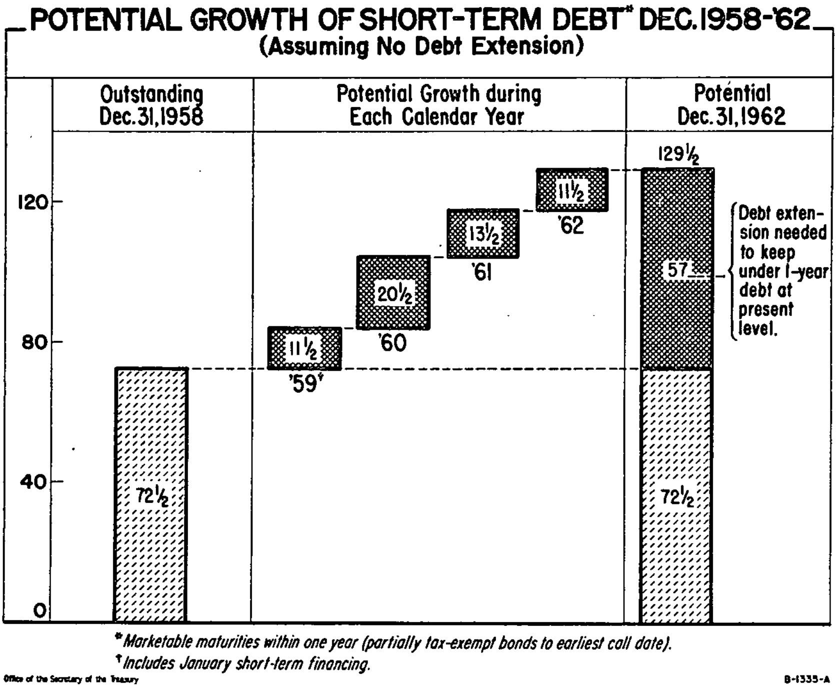
The rate of economic growth and the extent to which demands for funds exceed available savings will, of course, set the basic environment in terms of interest rates and credit availability in which the Treasury will have to operate. Our borrowing, just like that of any other debtor, will continue to be done in a market environment in which neither maturing issues nor new issues are supported by the Federal Reserve. Government borrowing is borrowing which must be done and cannot be postponed. Because of its size Treasury borrowing terms obviously have a greater impact on interest rates than the terms of any other borrower. At times monetary policy may seem to make debt management more costly and more difficult, but that should not be allowed to detract from the appropriateness of an independently conceived and operated monetary policy as a fundamental tool in the control of inflation.

We will continue in 1959 to pursue the major objectives which have guided our operations during the past year. The Treasury will continue to secure its necessary funds at as reasonable a cost to the taxpayer as possible consistent with the major objective of contributing to sound economic growth. We will continue to secure our funds as largely as possible from true savers rather than from commercial banks in order to reduce the inflationary potential of our financing operations during a period of rising economic activity.

We will also continue to take advantage of every opportunity which arises to extend the maturities of our issues in order to reduce to a minimum the disturbing effect of Treasury financing operations on the money markets and on the flotation of new corporate and municipal issues and in order to provide the Federal Reserve with the greatest freedom possible to conduct effective monetary policy.

If we do not seek every opportunity to accomplish debt extension we will find the short-term debt increasing to a new high in the years immediately ahead. The under-1-year debt, as is shown in chart 6, stood at $72½ billion on December 31, 1958. If no more securities longer than 1 year to maturity are issued during the remainder of 1959 the under-1-year debt will increase by $11½ billion during the year. Furthermore, the passage of time will bring more of the debt within the 1 year area in 1960, in 1961, and in 1962 so that financing exclusively in the 1 year area during the next 4 years (and with no increase in outstanding debt) would bring the amount of under-1-year debt to $129½ billion—about 75 percent of the total marketable debt outstanding—by the end of 1962.

CHART 6




The importance of sound fiscal policy in setting the environment in which debt management operations are undertaken cannot be overemphasized. The fact that a budget deficit means a larger amount of money to be raised is only a relatively minor part of this problem.

Far more important is the psychological reaction of investors to the prospect of the effect of future inflation upon the purchasing power of the dollars which they invest if they lack confidence in the ability of the Federal Government to manage its fiscal affairs soundly and to take whatever additional steps are necessary to minimize inflation. This is true not only in relation to Government securities, but to all other fixed dollar obligations as well. A budget deficit in a period of prosperity, and a growing public debt, mean just that much less opportunity for an expansion of mortgage debt, corporate debt and State and local government debt without running the risks of serious monetary inflation.

The CHAIRMAN. Thank you very much, Mr. Gable.

Secretary Anderson, I want to commend you for your very manly statement, in which you state that you overestimated your revenues in the last year.

If you will remember, almost a year ago you were up before us and at that time I told you that I thought you were greatly overstating the estimated revenues and you said that you were going to be far more severe than you were willing to admit, and that you stood on the estimates.

Now, with the passage of time, I take it that you now say that you were wrong. Is that right?

Secretary ANDERSON. Senator, certainly the estimates were not realized that we anticipated last year. I think that, as the Senator knows, most of the shortfall resulted from the decline in corporate profits. Personal income fell only a very small degree during the period, being supported in part by transfer payments which are part of our stabilizers.

The CHAIRMAN. You will also remember that I urged you to ask for a larger increase in the debt limit than you were then willing to request, and I said that in order to save you embarrassment, and that I hope that you would not later have to come back and ask for a further increase in the debt limit. Do you remember that?

Secretary ANDERSON. I do, indeed.

The CHAIRMAN. And is it not a fact that in April you had to come back and ask for a further increase in the debt limit?

Secretary ANDERSON. We did.

The CHAIRMAN. And is it not true that at that time I again told you that I thought you were underestimating the increase in the debt, and that therefore, to save you further embarrassment, I hoped that you would ask for a further increase in the debt limit. Do you remember that?

Secretary ANDERSON. Yes, sir.

The CHAIRMAN. Then of course you returned in August to ask for an increase in the debt limit. And now the statement of Mr. Gable's indicates that you are coming in, in a little while, and ask for a third increase in the debt limit, is that true?

Secretary ANDERSON. Yes, Senator Douglas. You will recall that last year we asked for a permanent debt ceiling of $285 billion, and a temporary debt ceiling of $288 billion.

This was passed by the House, and in the Senate Finance Committee it was amended to provide a permanent debt ceiling of $283 billion, and a temporary of $285 billion.

We at that time stated that we did not think that the permanent debt ceiling that we received was adequate.

The CHAIRMAN. And what is the increase that you are now going to ask for?

Secretary ANDERSON. Senator Douglas, we are estimating that at the end of this year the debt will be $285 billion, which will be more than the permanent debt ceiling.

Now, we realize also that during the first half of next year we will have still some additional financing to do because of the way in which we collect our taxes.

I am not now prepared to say what we would have to ask for as a temporary ceiling above that $285 billion, but I think in the next 3 or 4 months we will have an answer to what we will have to ask for.

The CHAIRMAN. Well, Secretary Anderson, a lot of things that endear you to us up here on the Hill is your frankness and your gentleness of manner, and I hope that you will not resent it if I will say to you that it would be well in the future if your experts in the Treasury consulted some of us up here on the Hill in the question of receipts and expenditures, and you might find that our advice would be very helpful.

Now, Mr. Secretary, I notice that you mention inflation as a real danger. Has there been any real increases in prices during this year, that is during this last year?

I have before me, Mr. Secretary, the monthly "Economic Indicator," and on page 24 they give indexes of wholesale prices which show in December of 1957 an index of 118.5; in December of 1958, an index of 119.2, or an increase of only 0.7 of one point, and if you compare that with March of 1958, when the index wholesale prices are 119.7, we have had a decline in the last 9 months for which we have figures.

So, it decreased one-half of one point in 9 months.

On the preceding page there is the index of consumer prices which roughly shows that in March of 1958, the index was 123.3. In November it is 123.9, or an increase of only 0.6 of one point during the course of 8 months.

On the basis of the past year, can one say that there has been any real inflation?

Secretary ANDERSON. Senator Douglas, I would like to comment on this if I may.

The CHAIRMAN. Certainly.

Secretary ANDERSON. I think one has to take both a short- and long-range view, Senator.

For the short-range view I think you see a great deal of evidence of stability. As you have pointed out, all consumer price indexes have been relatively level. There has been no change in the value of the dollar since last June. There has been, if anything, a slight decline in the cost of living, primarily because of food prices.

We have excess plant capacity above what we are using. These are all factors which, for a short run, imply a degree of stability.

The CHAIRMAN. May I inject at this point that we have had a number of witnesses before us in the preceding days of the hearings, and I think all of them, without exception, said that they did not anticipate any increase in the general price level for 1959. They did anticipate a fall in the prices of farm products, which they thought would offset any increase in the industrial sector.

No one predicted an increase in 1959, so I would like to know just when you expect this increase in prices, or your fear of an increase in prices to take effect?

Secretary ANDERSON. I would not be in a position to precisely pick out a time, but I would say that the time and the place to deal with inflationary pressures are when you do have a period of relative stability.

One does not want to wait until you have such pressures built up through continuing deficits or through any other factors which have to be taken into consideration, for the evil to come upon you. You want to try to avoid it by following a fiscal policy, and this involves policies both of labor and management; policies of pricing; policies of wages and price costs.

All of this sort of thing one wants to deal with at the time when you do have relative stability.

The CHAIRMAN. Of course, Mr. Secretary, we also have to deal with the issues which are immediately before us, and we have to keep them in mind too, and some of us are quite well aware of the fact that we have 4.1 million unemployed men in the country. And certainly, the involuntarily part-time employed, if they were added in, would increase the aggregate by the equivalent of another million fully unemployed.

Our rate of growth has been apparently running somewhere around 2 percent a year, somewhat less than our past record of growth, and appreciably less than the rate of growth for our European allies.

While I shall not make a detailed comparison with Russia, is it not true that we are making a rate of growth less than Russia?

Therefore, while we believe in price stability, we believe in maximum employment also, and also in maximum growth rates.

Now, each specialist tends to think of his particular specialty and it is a habit of the Treasury officials and the bank officials all over the world to think primarily in terms of price stability, but we have to legislate for the Nation as a whole, and while we take into account price stability and want to protect it we also have to take into account unemployment and the necessity for reducing that, and we must take into account our growth.

Secretary ANDERSON. Senator Douglas, I would say that I share the Senator's concern for every person in this country who is unemployed.

I believe that what we want to develop is an economy that will provide growing job opportunities.

Now, it seems to me that the best way in which to provide those job opportunities is to have a confident expanding economy, and an economy that expands in real terms, real goods, real services, real wages, and we are now in a period of increased activity.

If we maintain a confident belief in our currency, we will have capital accumulation that will provide the new means of production which is necessary for the jobs.

The real solution to the unemployment problem is to have a healthy economy, a sound and confident economy, and an economy that grows in real terms.

The CHAIRMAN. I will ask one more question, and then proceed to Congressman Kilburn.

Do you see any danger, Mr. Secretary in your almost exclusive concentration on anti-inflationary measures at a time of relative price stability that you may harm reemployment and growth? This, I think, is one of the most serious questions.

Secretary ANDERSON. Senator, I would not like to believe that I am obsessed with the inflation problem. I am concerned about it. I think the time to meet it is when we have this relative stability.

I do not believe that we should, at any point, just seize upon one factor and say that this is all controlling, and yet, we should not minimize the dangers which might come from it.

I do believe most sincerely that if we are to have growth in real terms, that we must have it in an atmosphere in which there is confidence in our currency and in which capital accumulation is encouraged; in which savings are a part of our national pattern of habits in order that we can have the kind of development capital within our own country that will absorb these maybe 1 million new people coming into the labor market each year.

Representative KILBURN. Mr. Secretary, I think you made a fine statement and I agree with it.

There is one sentence in your statement which I hope everybody in the country will read. With the chairman's permission, I would like to read it over again. You say:

> If we ever reach the point where people believe that to speculate is safe, but to save is to gamble, then we are indeed in trouble.

In my small way I have seen some evidence of people who would naturally put their savings in a bank or in Government bonds, but because of the inflation we have had in the last 20 or 30 years, are a little leary about it and are now starting to buy common stocks.

Secretary ANDERSON. Yes, sir.

Representative KILBURN. But that sentence, I think, is an extremely well-stated sentence.

Secretary ANDERSON. Thank you, sir.

Representative KILBURN. Mr. Secretary, there is one thing I would just like to ask you. I have repeatedly heard the statement—in fact, I heard it on the House floor yesterday—that the Federal Reserve sets the money rates.

Now, I always thought that the function of the Federal Reserve was to cushion fluctuations and they tried to manage monetary affairs in such a way that there will not be sharp economic fluctuations.

Do you not believe that in this great, big, wealthy country of ours that money rates are set by the laws of supply and demand?

Secretary ANDERSON. Yes, sir. I do.

Representative KILBURN. That is all.

Representative PATMAN. Mr. Secretary, in the budget there is an item of about $335 million in which it is proposed to sell FNMA mortgages to banks and in that way to "balance" the budget. Are you acquainted with that budget item?

Secretary ANDERSON. Yes, sir.

Representative PATMAN. Now, do you consider it a good thing to sell off assets of the Government for the purpose of balancing the budget? After all, this is selling an asset that the Government owns, as if that could in any real sense balance the budget.

Do you endorse that as a Government policy, Mr. Secretary?

Secretary ANDERSON. Congressman Patman, the act which created the Federal National Mortgage Association provided that we should, to the maximum extent and as rapidly as possible, have private financing substituted for Treasury borrowings that would otherwise be required to carry mortgages.

Now, over the period of the FNMA history, they have sold, as I recall, about a $1,600 million worth of these mortgages.

Representative PATMAN. But I am talking about selling $335 million to apply on the budget. It occurs to me that if you are going to endorse the policy of selling assets of the Government for the purpose of trying to balance the budget, it will possibly lead to the sale of such things as, for instance, Grand Canyon or Yellowstone National Park, or a few acres of the Capitol Grounds.

I don't think we should endorse or be misled by a policy of selling our assets as a device for "balancing" the budget.

Now, I have some questions about that, Mr. Secretary, which I shall not burden you with by reading, but I would like to get your answer to them for the record, if you please.

Will that be satisfactory to you?

Secretary ANDERSON. Yes.

Representative PATMAN. Such questions are: With what financial institutions would these exchanges be transacted? How would these institutions be selected? What mortgages now held by FNMA would be offered in the exchange? There are other questions also but I will give this to you now. I will then file one for the record also.

Secretary ANDERSON. You would want me to prepare answers and send them back to you?

Representative PATMAN. And submit them for the record, if you please.

Senator DOUGLAS. Without objection, it is so ordered.

(The questions and answers referred to are as follows:)

ANSWERS TO MR. PATMAN'S QUESTIONS

1. Q. With what financial institutions would these exchanges be transacted? How would these institutions be selected?

A. The present plan is that the exchange of mortgages for Government bonds would be limited to those financial institutions which are qualified to invest in FHA-insured and VA-guaranteed mortgages and which are the holders of 2¾ percent Treasury bonds, investment series B. On December 31, 1958, these bonds were held as follows (excluding holdings by Government investment accounts):

| | *Million* |
|---|---|
| Commercial banks | $130 |
| Life insurance companies | 1,898 |
| Mutual savings banks | 882 |
| Fire, casualty, and marine insurance companies | 144 |
| All other [1] | 2,496 |
| Total | 5,550 |

[1] Includes individuals, nonfinancial corporations, pension funds, savings and loan associations, State and local governments, and miscellaneous investors.

2. Q. What mortgages now held by FNMA would be offered in the exchange? What rate do they carry?

A. The principal mortgages in the management and liquidating portfolio of FNMA which would be eligible for exchange are about $1 billion of VA-guaranteed 4 percent mortgages.

Q. What is their current market value?

A. Since FHA and VA mortgages carrying a 4 percent interest rate are not, generally speaking, available for purchase, there is no "current market value," as such. On a yield basis, the probable current market range would likely be between 86–88–90. Considering the seasoned character of the mortgages, the relatively early maturities, and the nature of the proposed exchange, the value of the mortgages should approximate the value of the bonds.

Q. At what value are they carried on FNMA's books?

A. These mortgages are carried on the books of FNMA at par, or 100 percent of their unpaid principal amount.

Q. Is there any statutory restriction against their sale by FNMA at less than par?

A. There is no statutory restriction against the sale or exchange of these mortgages by FNMA at less than par.

3. Q. What Government bonds held by the financial institutions would be exchanged for the mortgages? Are they marketable issues?

A. The 2¾ percent Treasury bonds, investment series B, are not marketable bonds. They may be exchanged at the election of the owners into 1½ percent 5-year marketable Treasury notes.

Q. What rate do they carry?

A. These bonds bear interest at 2¾ percent.

Q. When do they mature?

A. They mature April 1, 1980, but may be redeemed at the option of the United States on and after April 1, 1975, at par and accrued interest on any interest day or days on 4 months' notice of redemption.

Q. At what value are they carried on the books of the financial institutions?

A. This series of bonds was originally issued on April 1, 1951, at par in exchange for certain 2½ percent Treasury bonds. An additional amount of such bonds was issued in June 1952 for cash and in exchange for certain 2½ percent Treasury bonds. It is believed that the current owners of these bonds who are the original subscribers carry them on their books at par.

Q. What is their current market value?

A. The 2¾ percent Treasury bonds, investment series B, being nonmarketable, do not have a current market value, as such. They are exchangeable for 1½ percent 5-year Treasury marketable notes which have a current market value for the current issues of about 90½.

4. Q. In the exchange, would the financial institutions record the mortgages acquired from FNMA at par, at current market value, or some other basis?

A. We cannot say with certainty how the financial institutions will record these mortgages, and probably no single rule will be applicable to all. Since they will be receiving in exchange for their bonds securities of approximately equal value, some of these institutions will probably record these mortgages at the same book value as their bonds. Other institutions may record them at current market value.

4. Q. Will there be a book gain or loss for these financial institutions?

A. The answer depends, of course, upon how the financial institutions carry the bonds on their books and how they will record the mortgages they acquire. If, as indicated in the answer to question 3, the bonds are carried at par, and if the mortgages are recorded at par, there will be neither book gain nor loss. If the mortgages are recorded at their value at date of exchange, then a book loss will, in general, be incurred.

Q. If loss, what would be the tax treatment of the loss?

A. The tax treatment would be long-term capital loss or ordinary loss depending on the type of institution and assuming, of course, that it is not exempt from tax on this type of exchange.

Q. How much would this cost the Treasury in tax revenues?

A. On the basis of our best estimates at this time, the revenue loss will be insignificant. To the extent that loss on the bonds is claimed for tax purposes it will be largely offset by later equivalent gain on the mortgages.

5. Q. Would the bonds acquired in the exchange by FNMA be recorded on FNMA's books at par, at current market value, or at some other basis?

A. Because FNMA will get credit at par for these bonds in payment of its indebtedness to the Treasury, FNMA is entitled to record these bonds at par on its books. It is believed that FNMA should view the exchange of mortgages for bonds as being made on the basis of market values; but FNMA's temporary book loss on such exchange is promptly restored by the Treasury's acceptance of the bonds at par.

Q. Will there be a book gain or loss for FNMA, at this point?

A. At this point there will be a temporary book loss for FNMA, but FNMA's ability to get credit at par for the Treasury bonds it turns in restores the loss.

6. Q. What will FNMA do with the bonds if acquired?

A. It will turn the bonds over to the Treasury.

Q. Will they be presented to the Treasury for retirement?

A. Yes.

Q. If so, at what value will FNMA's account be credited—par value of bonds, market value, or what other?

A. With the par value of the bonds.

Q. Will this be the same, more than, or less than the book value of the mortgages exchanged?

A. On the basis of present values, as above indicated, for the mortgages and bonds the par value of the bonds will be approximately the same as the book value of the mortgages exchanged for them.

Q. If less than, how will this portfolio loss affect FNMA's financial position?

A. In the light of the answer to the preceding question, this question does not appear to be relevant.

7. Q. How will the Treasury's accepting the bonds and their retirement be reflected in the budget accounts?

A. Acceptance of the bonds at par and retirement of the bonds will be reflected in the budget as a receipt item (credited against the expenditures of the agency), just as the purchase of the mortgages was reflected in the budget as an expenditure item.

Q. If FNMA, upon presenting the bonds for retirement, is credited with the par value of the bonds, will the difference between the actual, market value of the bonds and their par value be reflected in any way in the budget accounts?

A. No.

8. Q. As a result of these transactions, will the Treasury's financing needs be increased, reduced, or unchanged from those that would obtain if these transactions were not undertaken? In other words, how would the Treasury's financing requirements be affected as compared with the situation in which FNMA, instead of exchanging the mortgages, offered them for sale in the market? Won't the Treasury, in any case, have to borrow an additional $335 million? At what interest rate do you expect to be able to borrow this amount is fiscal 1960?

A. The exchange of mortgages by FNMA for the 2¾-percent Treasury bonds and the retirement of such bonds by the Treasury would not increase, reduce, or change the Treasury's financing needs during fiscal year 1960. If a like amount of mortgages were sold by FNMA for cash, the receipt of such cash by FNMA and its payment to the Treasury in reduction of its indebtedness would reduce the amount of Treasury's cash financing by an equivalent amount, but would also have the effect of reducing by that amount the funds of private investors otherwise available in the market for mortgages.

The exchange of mortgages by FNMA for Treasury bonds and the retirement of such bonds by the Treasury, while not affecting the financing needs of the Treasury in 1960, would have the effect of reducing the outstanding public debt and thereby furnish a like margin under the public debt limitation which would be available for use by the Treasury.

In order to cover the estimated expenditures for fiscal year 1960 by FNMA for the purchase of mortgages under its special assistance program aggregating approximately $335 million, it will be necessary for the Treasury to issue a like amount of public debt obligations to obtain the necessary funds for this purpose. It is impossible to determine at this time the character of obligations which will be issued by the Treasury or the rate of interest that will be payable on such obligations during fiscal year 1960.

(Representative Patman subsequently wrote to Secretary Anderson as follows:)

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
*Washington, D.C., February 20, 1959.*

Hon. ROBERT B. ANDERSON,
*Secretary of the Treasury,*
*Department of the Treasury,*
*Washington, D.C.*

DEAR MR. SECRETARY: Thank you for the information concerning the proposed exchange of mortgages by FNMA for certain Treasury bonds, provided in the letter of February 19, 1959, from Assistant Secretary Robbins.

Certain points about the proposed exchange remain unclear. I am anxious to have a complete understanding of these transactions made available to the public through the published hearings of the Joint Economic Committee on the President's 1959 Economic Report. I would appreciate, therefore, a prompt reply to the additional questions attached herewith. In order that publication of the hearings not be unduly delayed, may I have your reply by noon, Tuesday, February 24?

Thank you for your assistance.

Sincerely yours,

WRIGHT PATMAN.

ADDITIONAL QUESTIONS CONCERNING THE PROPOSED EXCHANGE OF MORTGAGES BY FNMA FOR CERTAIN TREASURY BONDS

1. In the answer to question 1, you show the distribution by type of holder of the currently outstanding $5,550 million of 2¾ percent Treasury bonds, investment series B. As reported in the budget, only $335 million of FNMA mortgages are to be offered in exchange. Since only a small fraction of the total 2¾-percent Treasury bonds, investment series B, will be accepted in exchange for the FNMA mortgages, wouldn't it be necessary to choose among the present bondholders those to be eligible for the exchange? Which of the present holders of the 2¾-percent Treasury bonds, investment series B, will be selected to engage in the proposed exchange? How will the selection be made?

2. In the answer to question 4, you indicate some uncertainty about the manner in which the bondholders will record the FNMA mortgages acquired in the exchange. Yet you state that your best estimate is that the revenue loss will be insignificant. In order to make a revenue estimate, don't you have to make some assumptions about the class of bondholders whose bonds will be accepted in exchange for the FNMA mortgages and, moreover, some assumptions about the basis of the bonds in the hands of these holders and the basis of the FNMA mortgages in their hands? Since these respective bases will determine in large part the immediate tax consequences of the transaction, shouldn't the question of basis for the FNMA mortgages acquired be of considerable concern to the Treasury? Isn't the Treasury in a position to issue a ruling setting forth the basis to be used? If not, shouldn't the Treasury seek legislation to insure that no tax loss will result from the transaction?

3. What is the volume of the VA-guaranteed 4-percent mortgages now held by FNMA? What is the maturity schedule of these mortgages? Which of these would be offered in exchange for the 2¾-percent Treasury bonds?

4. The answers under questions 2, 3, and 4 suggest the possibility that the exchange will be treated by the present bondholders as a straight par value dollar-for-dollar exchange. In other words, for each par value dollar of 2¾ percent Treasury bonds, investment series B, given up, the present bondholders will get a par value dollar of 4 percent VA-insured mortgage. According to the answer, the VA-insured mortgages are seasoned and have a relatively early maturity, whereas the investment series bonds do not mature until 1980, callable in 1975, and while nonmarketable, are nevertheless exchangeable for 1½ percent 5-year Treasury marketable notes which are currently selling at a 9½ point discount. Isn't the net effect of the proposed exchange, therefore, to give the present bondholders higher yielding assets than they now hold without any real capital loss (perhaps even with a real capital gain), even though they may be able to claim a capital loss or an ordinary loss for tax purposes?

5. The answer to question 8 indicates that in fact the proposed exchange will leave the Treasury with the need for borrowing $335 million, just as if the level of mortgage purchases by FNMA proposed in the budget were to be financed without recourse to additional sales or exchanges by FNMA. Is this inference correct? If so, what useful purpose is served by the proposed exchange of FNMA assets for Treasury bonds of a lower yield?

6. The effect of the proposed exchange, as shown in the budget, is to reduce FNMA budget expenditures by $335 million. The answer to question 8 seems to state in effect that the proposed exchange does not affect the real volume or character of FNMA operations for the fiscal year. That is, the proposed net absorption or release of investable funds as a result of FNMA operations will not be affected by the proposed exchange. Is this inference correct? If so, doesn't it mean that the budget expenditure savings of $335 million is merely a bookkeeping savings?

7. The answer to question 8 also states that the proposed transaction, while not reducing the Treasury's cash needs, will have the effect of reducing the outstanding public debt, thereby furnishing the Treasury somewhat greater leeway under the present public debt limitation. Is this the major public pur-

**pose to be served by the proposed exchange? If so, isn't the price to be paid—the possible loss in tax revenues, the reallocation of interest payments to private holders and away from FNMA, and the very likely net increase in total interest payments—too high?**

(Mr. Anderson's reply to the above appears at p. 770.)

Representative PATMAN. In your statement you say that during prosperity a deficit which is financed through the banks in itself brings inflationary consequences. I agree with your statement and I think that we should avoid financing of any kind through banks that create money, for the purpose of buying the bonds. I am sure that you look with disfavor on what happened the past year when the commercial banks had their reserve requirements reduced enough to wher they could, without any cost to themselves, by $10 billion worth of Government bonds.

Now, that is about as near interest-free money as you can make it, is it not, Mr. Secretary?

Secretary ANDERSON. As you will recall from Mr. Gable's statement, in the first half of last year there was a considerable increase in bank purchases of Government securities. This was at a time in which the problem before the country was one of recession.

It was also at a time in which the Federal Reserve policy was to loosen the monetary restrictions. It was at a time in which it would seem to me that the expansion of bank credit through this mechanism was a complement to what we were trying to do.

Now, as one approaches periods of high levels of activity and prosperity, one would not want the same amount of bank financing, and I think that, as Mr. Gable pointed out again, we have met with some reasonable success in the latter part of the year in financing our debt outside of the banks.

Representative PATMAN. I want to disagree with my good friend, Congressman Kilburn from New York in his statement that the market money rates are fixed by the law of supply and demand.

My personal opinion is, that the Federal Reserve fixes the money rates. It is done deliberately. It did so over a period of 13 years or more when they held the long-term bond rate at 2½ percent.

The Chairman of the Federal Reserve Board has testified at different times that they can fix the mony rate at any rate they want to and hold it there. They can fix it at 2 percent, 2½ percent, or 4 percent, and they can hold the rate where they fix it.

I think you would have to agree, that with all the monetary weapons that they have at their command—open market operations and discount rates—that they are probably right. They could fix the rate at any rate they wanted to fix it, and hold it there.

Would you agree or disagree with that?

Secretary ANDERSON. Well, I would say, sir, that the Federal Reserve is certainly an influencing factor.

I do believe that they are not the sole influence and that the real rates are fixed largely by laws of supply and demand, although influenced by the kinds of controls which the Federal Reserve can have.

They are influenced by the kind of action which the Treasury finds necessary. If, for example, we have a deficit and we have to go into the market to finance it, we are influencing the market in that we are borrowing large sums of money.

We are also influencing it to the extent that we lodge our securities in the banking system, and I think all of this has to be taken together.

Representative PATMAN. Now, Mr. Secretary, under the law the maximum rate that may be paid on long-term Government bonds is set at four and a quarter percent.

Do you contemplate coming to Congress with a proposal to raise that ceiling in the near future, Mr. Secretary?

Secretary ANDERSON. I do not now have any plans to ask for an increase above 4¼ percent.

As the Congressman has noted, the rate applies only to bonds. It does not apply to certificates or notes.

Representative PATMAN. I cannot understand, Mr. Secretary, two things: No. 1, why you don't sell all of your bonds in competitive bids, and No. 2, why should you sell short-term bills—90 days or 180 days to the banks at all when you know they are creating the money on the books, and at a currently very high rate of interest. For 13 years the rate on bills was three-eighths of 1 percent. Today, it is over 3 percent, or at least around 3 percent. You could instead work out a policy with the Federal Reserve and with Congress whereby you could get your short-term financing needs through the Federal Reserve directly, and the interest paid would then flow back into the Treasury and save the taxpayers that much money.

Have you given consideration to that?

Secretary ANDERSON. Well, responding to the first question, I do not believe that we have a sufficient market capability of financing the debt of this size wholly through the auction system. This might be done in the big money centers, and as you know, we auction bills every Monday.

On the other hand, if every security were auctioned, it would be very difficult for the small banks or the intermediate banks, the country banks, to compute and to get in bids. It would be very difficult for them, to make a judgment or to have the capacity for the making of a judgment as to what kind of a bid to put it. I think if the Government went into the market and kept open its offerings over a considerable period of time, that would seriously interfere with corporations and municipalities, and States and other institutions who want to go to that same market for their funds.

One of the things that concerns me, of course, is the number of times which we have gone to the market in a year, because each time we go into the market we cause it difficulty until our issue is absorbed for the rest of the corporations and municipalities and others who want to go to the same market.

This is one of the reasons, of course, that I am concerned about the structure of the debt.

Representative PATMAN. By time is running out, but I do wish you would answer briefly the second question, and that is, have you given consideration to selling the short-term bills, even as long as 6 months to the Federal Reserve directly and saving for the taxpayers the interest that would be paid?

Secretary ANDERSON. Congressman, let me point out two things: No. 1, as I recall it, the commercial banks only own about 3½ billions out of the short-term bills, that is, out of about 24 billions.

In the second place, it seems to me that if you go to the Federal Reserve to market these securities, you would simply be adding to the money supply. Now, adding to the money supply through the Federal Reserve purchasing bills would be no different.

Representative PATMAN. That is right, but you would save the interest.

Secretary ANDERSON. Well, you would be saving the interest on that particular issue, but at the same time the addition of Federal Reserve credit to this large amount, I think, would be inflationary.

Representative PATMAN. Mr. Secretary, may I state that the Federal Reserve System could immobilize these reserves.

Seceretary ANDERSON. Let me make one observation on that. What the Congressman assumes, I think, is that you would immobilize the inflationary effect by simply increasing your reserve requirement.

Representative PATMAN. There are several ways of doing it—of "freezing" the reserves.

Secretary ANDERSON. If you freeze the excess reserves by raising reserve requirements, you would be immobilizing the inflationary impact to the extent of the secondary effect of the money going into the banking system, so that it would not have a multiple capacity to lend. You would not be immobilizing it to the extent that borrowing from the Federal Reserve puts this much money into the system itself.

Representative PATMAN. Have you given consideration to it, Mr. Secretary? Have you tried to do it in order to try to save interest?

Secretary ANDERSON. I have thought of it, Congressman, but I have not thought it to be a wise course for us to follow.

Representative PATMAN. I think it would be well to ask the Federal Reserve to see what they come up with.

The CHAIRMAN. Senator Bush.

Senator BUSH. Mr. Secretary, I certain congratulate you on your opening statement and I venture to hope that every Member of the Congress will find time to read it.

I particularly call attention to the paragraph in your statement where you say the fact of the matter is there is nothing which is more positive and more important than fiscal soundness. This is an essential condition to our economic health, without which we can have neither military security nor the adequate provision for other needs of Government. A healthy economy is a highly positive objective which deserves the support of everyone.

Now, Mr. Secretary, I have two or three questions here. One of them is suggested by my friend Congressman Patman when he spoke of the FNMA mortgages, some $350 million. Mr. Patman objects to that sale, apparently, because it is a Government asset.

I would like to ask you this question: Were not those mortgages purchased with the taxpayers' money?

Secretary ANDERSON. Yes, sir.

Senator BUSH. They were purchased with the taxpayers' money. Now, if you are going to sell them, what are you going to credit? It seems to me you have no authority, no alternative except to credit the taxpayers.

I would like to point out in that connection that far from criticizing that move, I think it was a very logical one, and I pointed out yesterday on the Senate floor that there are some $5,400 million worth of these mortgages already in the Treasury of the United States, and that it is a shockingly large figure.

When FNMA was originated, it was originated first to provide a secondary market for mortgages, an in-and-out account to help the marketing of mortgages; it never was intended that it should become a more or less permanent repository of mortgages amounting to upward of $5 billion, which is what it was at the end of 1958.

I venture to hope that you might find even more opportunity to reduce that account so as to relieve the taxpayers of the unnecessary burden of carrying these very large amounts of mortgages.

You were out in India, Mr. Secretary, last fall. I notice that the Chairman of the Federal Reserve Board was also around that part of the world, in the Far East. When he returned he made a statement in which he said that many people out there in the Far East were looking somewhat askance at the United States concerned that it was unable to balance its budget and keep its fiscal affairs in order.

I wonder if you ran into any questioning along that line from the representatives of other governments with whom you met out there?

Secretary ANDERSON. Yes, I did, Senator Bush.

A great many of the countries, as I indicated in my statement, have a keen awareness of the way in which we manage our affairs. They probe very carefully into our budgets and the ways in which we raise our taxes and the ways in which we meet our deficits.

A great many of the nations observed over the years that we have said to others that the way you attract capital is to compete for it. If you compete for capital, capital has to be sure that it is safe; it has to be safe from expropriation, it has to be safe from serious devaluation.

Now, they are concerned, of course, that we give a role of leadership in maintaining fiscal soundness within our own country, because this is the sort of thing which we have been saying to others for a great many years.

Senator BUSH. Mr. Chairman, I think we should remember that the defense of the free world depends in very large measure upon the credit of the Government of the United States. I believe that in making this point, about the absolute essentiality of fiscal soundness, the Secretary is right when he says that without an orderly fiscal procedure in this Government, we actually endanger adequate military security, not only for ourselves, but for people of the free world.

I do not think any year in history is so important in this connection as this very one in which we live. Never before have we been threatened with the mortal danger with which we are now threatened when any weakening of our fiscal and montary practices can dangerously undermine the security of the United States and the free world.

I see my time is about up, Mr. Chairman, but my good friend, the Senator from Illinois, has very properly emphasized our concern with full employment, and the Secretary himself has emphasized that. But I want to ask: Is it not true that if we have an unstable currency and if the savers of our country begin to lose confidence this also could have a deleterious effect on employment, because it would slow down investment, it would slow down the creation of new plants, the extension of present plants, and thus interfere with job-making opportunities?

Do you not agree that the condition precedent to full employment must be a sound dollar and relative stability of prices?

Secretary ANDERSON. Yes, Senator; I believe that, as I said to Senator Douglas, when I told him that the principal ingredient to maintaining a rate of growth that will absorb those that are coming into the labor market and provide the widest number of job opportunities for those in the market, is to have a healthy economy.

Now, a healthy economy, I think, depends upon confidence in the monetary system; confidence in the way in which we manage our fiscal affairs.

Senator BUSH. Mr. Chairman, I simply want to say this is the first meeting of this committee that I have had the privilege of attending.

I am very glad it is presided over by a gentleman who has a good background, one of knowledge and experience in this general field of economics. He has made some of the soundest and most valuable contributions to our thinking; at the times when this country needed his voice, it was the loudest and the firmest and the strongest in defense of a sound currency and orderly monetary practice by the Government of the United States.

With that, I think we are very fortunate in having him as chairman of the Joint Economic Committee in these very dangerous times.

The CHAIRMAN. I want to thank my colleague for these very kind words.

Senator O'Mahoney?

Senator O'MAHONEY. Mr. Secretary, it is always a pleasure to listen to you testify. You are frank and you are direct and engaging in your personality, so that we get along fine.

Frankly, I am at a loss at this point to discover from the "President's Economic Report," from the testimony which has been made by representatives of the Executive, as to what precise policy the Executive plans to follow in order to stimulate and expand economic growth.

We hear a lot of talk about stability of prices and sound financing, but I am a little bit puzzled in determining what the definition for "sound financing" is when I look at the current tables of the prices of Treasury bonds.

In last evening's Star, February 4, datelined from New York, we have a list of all the Government securities and present values. The table also shows the net changes which took place in the market yesterday. In 10 cases out of the total list of securities prices were down. The yields on Government securities of all kinds have been generally rising, because the public and the banks are paying less and less for these securities which the Treasury has to issue to meet the obligations of the Government.

Is that evidence of stability and progress? When do you think our bonds and securities will be selling at par again? What should we do, if there is anything that we can do, to see that they sell at par?

Secretary ANDERSON. Senator O'Mahoney, going first to your problem of growth, I would suppose that the Senator is troubled in part by not finding specific projects which can be related to a specific industry, or to a development of a specific kind, a segment of the economy.

I think we are all acutely conscious of the need for economic growth and for the purpose of raising our domestic living standards, and maintaining a sound defense, and of helping other countries.

If one looks back at GNP, for example, over the years from 1952 to 1957, it increased by 15 percent.

Personal consumption of the same period of time has increased by about 21 percent, so that we have gone well along in trying to further the true objectives of an economy, and that is providing the things which people want for better standards of living.

Senator O'MAHONEY. But, isn't it true, Mr. Secretary, that consumer credit has been expanding just like Government borrowing has been expanding?

The table which we have in the "Economic Indicator," on page 28, entitled "Consumer Credit" shows that in 1939 total outstanding consumer credit amounted to $7,222 million, that there was a steady increase in the succeeding years. 1948, it has risen to $14,398 million. In the next year, over $17 billion. And the next year, over $22 billion, and so forth, on down to 1957, when it was $44,774 million. As of November 1958 it was $43,464 million.

Does not that seem to indicate that the large segment of the population, like the Government, is living beyond its actual means, is living on borrowed money?

Secretary ANDERSON. I do not believe that one would be in a position to judge the extent to which people are living beyond their means by the rise in consumer credit, and consumer borrowing. One would have to have some way of evaluating the soundness of the borrowings of the people before you could adequately speak to the point.

I do think, on the Senator's other point, that these fluctuations he mentioned—I would like to suggest that we look back on this 18-month period.

If one looks back to the summer of 1957, the great debates in our country were then on economies.

When the Congress adjourned, it was after a series of efforts by everyone to be as economical as possible. We were then talking about avoiding inflation and that sort of thing.

In a very few months, that was by January of 1958, this had completely reversed itself. We were talking about a recession, about how to get out of a recession, about measures in order to prevent the recession deepening, and I say, by August or September of last year we had gone the full cycle, and we were talking about inflation again, and how to deal with the national deficit and that sort of thing.

Markets respond, I think, to actual conditions, and they respond as well to psychological conditions, and it seems to me that we have, from time to time, had exaggerated ideas as to the changes which take place in our economy.

I think the interest differentials that you have referred to, have made the job of Treasury financing much more difficult, but it also seems to be that they stem primarily from the changed economic conditions here through last spring, when we were liquidating inventory at the rate of $9 billion a year.

We were all concerned with stepping up productivity, of getting back to prosperity.

Then, with the coming of the large deficit, and at the same time the realization that you had a turn in the economy, the combination of these things, the additions of tensions, such as the problem that occurred in Iraq, the problem that occurred in Jordan, all had an impact in making the market move very rapidly.

Senator O'MAHONEY. What are we going to do about the situation? We talk of great prosperity. We talk about the termination of the recession of 1954. We talk about new revenues coming in, but at the same time that we talk about those things, we find our Government securities falling on themarket. How can we adjust those two facts and imagine that we are in a prosperous condition?

Secretary ANDERSON. It seems to me again, that the real contribution that we can make is to follow a fiscal policy that will give confidence to all of our people that we are going to measure, and have prosperity in terms of real goods and services and wages.

Senator O'MAHONEY. Did I understand, from one of your answers to Senator Douglas, that you will ask Congress again this year to increase the ceiling on the debt?

Secretary ANDERSON. Yes, we will.

Senator O'MAHONEY. Well, if you have to ask Congress to increase the ceiling on the debt, at the same time that the "Economic Report" is predicting new and increased revenues, why is it necessary to issue new securities and borrow additional cash?

Secretary ANDERSON. This is the very point that I referred to in my statement, Senator, that one of the things that troubles us all is that you do not deal with a deficit purely during the time that you may be having a recession that is in part causing the deficit, but you have the problem of dealing with a substantial part of that deficit after you have turned and moved toward prosperity.

Now, the net effect of what we will be doing over the next several months will be stimulating to the economy.

Senator O'MAHONEY. Isn't it a fact, Mr. Secretary, and I think this will be my last question, that the Treasury financing policy is bringing about a steady increase in the annual rate of interest that is paid upon the national debt?

The budget estimates the interest on the national debt for the fiscal year 1960 at $8,096 million. It was scarcely $6 million back in 1953.

Here is a steady increase in the amount of money that the taxpayers of the United States must pay on the securities that have been issued.

This is steadily increasing, and it is second only to the expenditures for national defense set forth in the budget. It doesn't seem to me to be an indication of the program designed to promote the stability of the dollar or the credit of the United States.

Secretary ANDERSON. Senator, if I may make two comments. The Treasury has to deal with the deficit because the deficit resulted both from increased expenditures, and from short falls in its revenue collections.

So, it has become a fact of life with us. We have to go into the market and get our money in the same place that other borrowers get their money.

Now, the best way that I would know to make capital available on easier terms is for the Federal Government to stop increasing its borrowings and if possible, to pay something on its debt.

This would be helpful to all borrowers. It would be helpful in every walk of life, small businesses and everything of the sort.

Now, this is the very reason that we do not want to add to this problem by creating additional deficits, and we have to go into the market and finance.

Senator O'MAHONEY. What policy has the executive branch of the Government, the Budget Bureau, the Treasury Department, and all others, what policy have they presented to us in this "Economic Report" which would be designed to increase the revenue of the Federal Government and to increase the income of the people of the United States? I find very few suggestions in the report.

The CHAIRMAN. Senator Javits, I am very glad to welcome you to this committee.

Senator JAVITS. Thank you, Mr. Chairman, I would like to join my colleague, Senator Bush, in expressing gratification for the chairmanship of this committee.

The CHAIRMAN. Thank you.

Did you have some questions, Senator?

Senator JAVITS. Mr. Secretary, one thing interests me, and I think it would interest the country.

We have normally accepted it as a dominant faith of the administration that we want a secure Nation and an effective Nation. From all the conversations which have been had on the subject, would you now clarify for us whether the administration's primary faith has changed from a peaceful security and effective Nation, to a balanced budget?

Secretary ANDERSON. Senator Javits, I believe that a country that is as wealthy in resources as ours, that is as diversified as ours, that is as possessed of the skill and the competence of our country, can do all those things which are necessary to be done, and it can do a great many of those things at any given time that are desirable to be done.

I believe that a nation, like everybody else, must decide in any given point of time that it will do all that is necessary, and it will do as much of the desirable as it can.

Now, certainly we believe in a secure and a growing country. We believe in protecting ourselves, but as a corollary to that, it seems to me that we have to have a growing economy; an economy in which people have confidence and faith; that the growth is in real terms and not in some illusory terms, and that is the thing we try to achieve, a sustainable rate of growth under these terms.

Senator JAVITS. I notice that the presentation of the administration is based upon the words "prosperous, peacetime." The President used them. They are used throughout here.

Do you consider a period in which we are spending 59 percent of the budget for defense to the ringing tune of almost $50 billion a peacetime?

Secretary ANDERSON. Well, it is certainly a period of tension, and it is a period during which we have to, in order to insure peace, provide the kind of military security that is determined to be necessary for us.

Senator JAVITS. Would you say, therefore, that the administration is prepared to call upon the American people, if need be, in the spirit of sacrifice or whatever else would have to come from them in order to mount an adequate defense?

Suppose we need more money for defense. Are we prepared to ask for it?

Secretary ANDERSON. Well, as I have indicated in my statement if there develops identifiable, real, requirements for additional revenues, I believe that our country would be prepared to make up the difference.

Senator JAVITS. We would certainly agree upon putting defense in that category. Would we put foreign, economic aid in the same category?

Secretary ANDERSON. We get into areas of judgment. I think we have to realize that we have a system of taxation now that is quite burdensome. There would be some point at which there would be a serious impediment to additional growth, if you would take money out of the economy for any purposes of Government, and I think that one simply has to be analytical and say put some evaluation upon your efforts. Let's save so much of it for defense, so much of it for helping our allies around the world, and so much of it for developing our own internal economy, and about all of these things there might very well be divided differences of judgment.

What we have prepared here, I think, are the judgments that we have been able to arrive at in doing what is necessary for the country and doing all that is desirable for the country and at the same time living within our means during periods of prosperity.

I think if we should not live within our means in periods of prosperity, people would have a right to ask us when can you live within your means.

Senator JAVITS. I just have one or two other questions. It seems to me, therefore, that from what you have said the impression that is abroad is that this whole budget proposition is absolutely inflexible, dollar for dollar, it just has to be so many dollars and so many cents; that this really isn't what you are after. You are after a principle, reasonably established within the field, but you are not prepared to say that if we exceed this budget by $1 million, it is going to wreck the whole business. That is the impression that the country has gotten, that every penny of this is exactly balanced out, and you can't move a hair of it without upsetting the whole thing. Is that so?

Secretary ANDERSON. There might very well be differences of opinion as to what each of the budget items should receive as their proportionate share of income of the Government.

Again, on these things there would be differences of opinion, but I do want to make this point—I do not believe that making a proposal of living within your means in times of high prosperity should ever be interpreted as being against some kind of program, or some kind of desirable development, or some kind of desirable objective.

It means rather and affirmatively that this country is going to try to be fiscally sound, is going to try to protect the integrity of our money.

We are going to be concerned with the growing number of people we are going to depend on social security.

We are going to depend on retirees who have their savings invested in life insurance, and all the other sorts of things which form a part of it.

It seems to me that what we need to think of is that we are affirmatively for a sound, fiscal system, and a sound confidence in our currency.

Now, if we are able to maintain it, we will have great accumulations of capital. Capital will then seek places to invest. It will invest in means of production.

As the capital invests in means of production, it makes for more job opportunities; it creates more things, both goods and services, and people and users.

It seems to me that we are talking about a healthy economy, one that grows in real terms.

Senator JAVITS. Mr. Secretary, my time is up. I just want to say this to you. I am all with you, in substance, but I differ with you on the idea that you are bound with steel chains by the concept of a balanced budget.

I feel that whatever we have to do for defense or whatever we have to do in our judgment in the national interest, that we must do it. But at the same time, we also have a moral obligation to find the means to pay for it.

The idea of running the country on the basis of what is required in the highest national interest, and then finding a firm obligation to pay your way instead of budget balancing as an end in itself is the thing I am talking about.

As I say, I am all with you and I certainly will pledge to you that I will do my best within the principles that I have stated.

The CHAIRMAN. Mr. Bolling.

Representative BOLLING. Mr. Secretary, the hearings today it seems to me to have brought out at least three facts.

First, that the economy is not expected to regain levels of maximum employment and production until the end of 1959, at the earliest. Second, the outlook this year is for continued stability of prices. Third, the $77 billion budget limit on expenditures has been achieved by cutting what, to at least a number of people, seems to be well-justified budget requests, military as well as civilian.

In light of this, why should a balanced budget of $77 billion be the cornerstone, apparently, of the administration's economic policy this year?

I realize you have answered that question at some length. I need to ask it in order to get it in sequence. Will you briefly summarize what you said earlier?

Secretary ANDERSON. May I take it in two parts?

Representative BOLLING. Certainly.

Secretary ANDERSON. One, if one looks at the underlying assumptions in which you arrive at what our revenues will be under the current tax structure, I think that they are reasonable assumptions.

As I pointed out, corporate profits have risen to the fourth quarter of 1958, to a level of $44 billion.

We are estimating that corporate profits will attain a level of $47 billion in calendar 1959.

The personal income has risen in December to a rate of $359 billion, and we are estimating that it will increase to $374 billion this year on average.

If one looks back at 1954–55, on a percentage basis, we are estimating both in personal income and of corporate profits and gross national products, something less of a rise in calendar 1959 than occurred in that period.

I have a table here that would give you the exact percentage figures. In 1954–55, the rise in gross national product was 9.5 percent.

We are now suggesting that it would increase 8.3 percent from 1958 to 1959.

The rise in personal income was 7 percent. We are suggesting that it would increase 5.8 percent, and so on down the line.

Now, as to the second part of your question the principle, it seems to me, is not just expressed in terms of a balanced budget as a statement, but it is a statement that we ought to live within our means, doing everything that is necessary to be done and everything that we can do that is desirable to be done.

If we find that there are other really necessary things that had to be done, then I think we have to look to additional sources of revenue in order to live within our means. But here, Congressman, we are at a point when we are at an alltime high of course in gross national product; at an alltime high for personal income; corporate profits are rising, and if in times like this we cannot live within our means, then I think it is very difficult to answer the question of when can we.

Representative BOLLING. Mr. Secretary, my only comment is that presumably if we follow the mandate of the Employment Act every year we are going to be at an alltime high in all those categories. Certainly, each year we are going to be at an alltime in population.

Now, are we supposed to believe, to quote Walter Lippmann:

> By a wonderfully lucky coincidence, the money needed for national defense is the amount of money we can afford to spend, if the budget is to be balanced and without raising the taxes.

Is this some miraculous condition that we come out just right?

Secretary ANDERSON. Let me make this point—it is very difficult, indeed, for anybody to sit down and say precisely what the revenue is going to be for this country 18 months hence.

As the chairman pointed out earlier, I went into a very elaborate statement last year as to the difficulty of this kind of problem.

On the other hand, the very budgeting process, the requirements of the budgetary law are that we make a calculation, as best we can, as to what this revenue estimate is going to be.

I will say that as far as the Treasury is concerned, we have not and we do not propose to try to make the judgments of other departments of the Government, whether it be the military service or others, as to what their requirements are.

We are going to do our best in trying to say that under the tax structure, this is the kind of revenue that we can anticipate.

Representative BOLLING. Mr. Secretary, over a 25-year period, from 1933 to 1958, the average rate of increase in all prices, as measured by the "implicit deflaters of the GNP," table 5 in the "President's Economic Report," has been 3¾ percent.

From 1952 to 1958 and from 1957 to 1958, the annual rate has been 2¼ percent, substantially less than the overall rate.

In light of the slower rate of increase in recent years, why is such great emphasis placed on trying to achieve greater price stability this year?

Secretary ANDERSON. Congressman, as I pointed out earlier, one has to look at this thing from the short and long range.

From the short-range point of view, we have a great many factors which point toward stability, and I have outlined them earlier.

On the other hand, one cannot minimize the effect that continued budget deficits would have, adding to the money supply during periods of high levels of activity.

Now, it would not seem to me to be the right thing to do to wait until you had these great increases in prices, and then to try to attack the problem. It would be better to attack the problem during periods when you have some price stability and eliminate, as nearly as you can, those things which would have inflationary pressures in the longer range ahead.

Representative BOLLING. It might also be said, not talking with that specific point in mind, but talking perhaps to needs, that it would be a good idea not to wait to do something about education until the catastrophe had arisen, or to do a little bit more in defense until, what some people refer to as a gap, has been closed. Granting the importance of maintaining the stability of prices and the fact that we must try to keep inflation in hand for many reasons, I would like to draw your attention to the fact that the statistical record shows in the 25 years since 1933, prices have increased, again referring to this "implicit deflator," in all but 3 years, and that in the 13 years since the end of World War II, prices have increased in every year but one.

Now, my question: Has this persistent upward movement of prices actually done great harm to the economy, and if so, in what respect?

Secretary ANDERSON. Well, I think if one runs down the figures that you see, that most of these are sporadic or occasional increases in prices, and not those that just come year after year.

On the other hand, I would point out that if we allow, for example, prices to rise substantially, you are going to have increased cost in all of our operations, particularly to the military operations in which you get nothing extra, but you simply pay more for it. If you pay more for it, you have to tax more heavily to get the money with which to do it, or you have to borrow more heavily.

Now, I would think taxing more heavily would certainly be an impediment to growth.

I would think going out and financing deficits continuously adding to our monetary supply would create inflationary pressures.

Representative BOLLING. Mr. Secretary, I would like some indication of what damage has been done to the economy in the last 25 years when we have had a persistent upward movement of prices.

We hear a great deal about how wonderful the economy is today. Therefore, obviously, it hasn't been irreparably destroyed by an upward movement of prices.

What is going to happen next year or the year after, that hasn't happened in the last 25 years, with a persistent upward movement of prices?

Secretary ANDERSON. Well, certainly during those periods, despite price fluctuations, we have grown.

It does not mean to say we would not have had more growth in terms of real goods and services had we not had those price increases.

We are simply trying to evaluate what might have happened if there had been no price increase.

Take, during the 1920's—we had quite a period of growth, and during the 1920's, we did not have price increases.

I don't think that you necessarily say that you have growth because you have price increases, or the price increases are catastrophic.

We simply want to say that to have growth in real terms, one ought to have fiscal soundness and a really healthy economy in which there is great confidence.

Representative BOLLING. Thank you. Mr. Chairman, I believe my time is up.

Senator DOUGLAS. Mr. Boggs.

Representative BOGGS. Thank you, Mr. Chairman. Mr. Secretary, I read your statement. I, unfortunately, didn't hear it. I was a bit late coming in. I would like to pursue, for just a moment longer, the line of examination of Mr. Bolling. I gather that the whole essence of your budget is an attempt to equate a balanced budget with inflation, or the lack of inflation. How much inflation have you had in the fiscal 1959 so far?

Secretary ANDERSON. As I pointed out earlier, early in the calendar year there was an increase in the cost-of-living index, as you will recall.

Representative BOGGS. I know, but was it, really? Our figures show none at all.

Secretary ANDERSON. I think there has been no change in the value of the dollar since June.

Representative BOGGS. Now, let us go back. The Eisenhower administration balanced the budget 1 or 2 years out of 6.

Secretary ANDERSON. Yes; 1956 and 1957, as I recall.

Representative BOGGS. So that he has balanced it 2 years.

Secretary ANDERSON. Two fiscal years.

Representative BOGGS. Now, how much inflation did you have in those 2 years of Government surplus?

Secretary ANDERSON. Prices in 1955 averaged 114.5; 1956, 116.2; 1957, 120.2.

Representative BOGGS. So in both years you had inflation; did you not?

Secretary ANDERSON. Increase in prices; yes.

Representative BOGGS. And in the biggest deficit year of all, namely this current period, you have had price stability.

Secretary ANDERSON. What we had this year—the first 5 or 6 months we had a recession, and the latter part of the year a movement upward toward recovery.

You see, as I pointed out in my statement, one of the troubles of these deficits is that its effect continues after the recessionary period is over, which, in part, brought it about, and extends into the period when you got relatively high levels of prosperity.

Representative BOGGS. Well, I sat on the House Ways and Means Committee back in 1941 when we were writing the wartime Price Control Act. We had quite a lecture on inflation which went on for about 6 months. I gathered that one of the prime causes of inflation is the old business of supply and demand. You have too much demand, and too little supply.

Now, in the present economy I know of no situation comparable to that. As a matter of fact, we have many, many industries operating at way less than capacity.

I was talking to some of my friends in the aluminum industry very recently and I said, "Is this prosperity knocking you over?"

and they said, "Quite the contrary. We are operating at 71 percent capacity, and we are not sure we are going to be operating at that high level next week."

It seems to me that there is a lot of loose talk about this so-called inflation and I have read pieces in the business journals about the "flight from the dollar," and yet, there is certainly no indication that the cost of production is any cheaper in the United States.

So, this sudden effort to equate over a particular 12-month period stability and the budget, doesn't add up to me. From the figures for the 25 years that Mr. Bolling has referred to, and taking each year of a balanced budget and comparing that with the amount of inflation in prices, I doubt if you would find any great correlation there.

Secretary ANDERSON. Congressman, again this is the long and the short-range views.

I do believe that we now have a great many factors which indicate stability.

I am very delighted that we do have them, but I do not believe that because they exist, as of this moment, one should overlook the fact that financing deficits, particularly in periods of high prosperity, if we have a continued growth in the country, would not exert inflationary pressures.

Now, there might well be differences of opinion as to how severe those pressures are, as to how much they will accomplish, but the one thing that we are dealing with is the fact of life itself. The other that we are dealing with is the psychological belief of the people.

As I pointed out earlier, if one looks back just 18 months ago and if you are out looking at this country purely objectively, you would have the feeling that in the summer of 1957 all of our efforts were directed toward economy.

By 1958, all of our efforts were directed toward stimulation, and 7 or 8 months later all of our efforts are directed again toward economy.

Representative BOGGS. That leads to another question that I was going to ask you.

Secretary ANDERSON. You have these wide swings of psychology which I think are exaggerated.

Representative BOGGS. But in this effort to equate these various things, would you equate the great economy wave of 1957 to the great recession of 1958 in any sense?

Secretary ANDERSON. Well, it seems to me that in 1957 you had a number of things occur.

In the first place, you were coming to the end of one of the biggest capital expansion periods in our history—1956 and 1957.

Actually, the declines came pretty early in 1957. I think that the realization of these things probably didn't come about, or we were not conscious of them until somewhere later in the year.

Representative BOGGS. You mean late in 1958 when the administration submited its budget estimates, in the beginning of 1958, you anticipated a balanced budget, or rather the administration did.

Secretary ANDERSON. We did.

Representative BOGGS. And you overestimated revenues by $6 or $7 billion.

Secretary ANDERSON. Yes.

Representative BOGGS. That leads to one other question, Mr. Chairman. You have some tax increases in this proposed budget, do you not?

Secretary ANDERSON. Yes.

Representative BOGGS. You ask for a penny and a half more on gasoline, for instance, and a penny more on postage. Now, you may not call that a tax increase, but the way you figure your budget it really is a tax increase so that you will really have how much anticipated taxes coming on.

Secretary ANDERSON. I don't remember the figures on the postage increase, Congressman. I would like to check our figures, but I think what we estimated was $76,500 million from present tax sources and $600 million from other sources which would be the other tax measures and increased nontax sources. The postage increase would operate to cut expenditures by something like $350 million.

Representative BOGGS. Well, to put it in another way, an increase dollarwise, of something over $9 billion in the fiscal year. Is that right?

Secretary ANDERSON. Yes.

Representative BOGGS. Are you convinced that the current rate of growth, of say 2 percent, will produce almost $10 billion of more revenues this year as compared to last year?

Secretary ANDERSON. Congressman Boggs, as I indicated we are estimating that we will have an increase of something less than occurred in 1955 to 1956. If one looks at the rates to which both corporate profits and individual income has risen in the last year, the last quarter of 1958, it would indicate a very vigorous recovery. We are anticipating that that recovery will continue with reasonable vigor.

In making our estimates, we did not use the most optimistic figures we could find, and didn't use the most pessimistic. We tried to steer somewhat of a middle course.

Representative BOGGS. Thank you.

The CHAIRMAN. Mr. Reuss, you have been sitting here patiently this morning. Would you conclude the discussion?

Representative REUSS. Thank you, Mr. Chairman.

Mr. Secretary, I was very much interested in your colloquy with Senator Bush concerning your travels to the Far East, and Governor Martin's travels to the Far East and the fact that numerous financial officials of other governments impressed upon you the necessity for fiscal soundness in our Government.

Curiously enough at the time you were in the Far East, I was with a Joint Economic Committee group, talking to many central banking officials of various countries of Western Europe. I was struck by the fact that most of these fellows held conservative views and placed value on fiscal soundness. By and large they thought we were sound, but they were deeply concerned that a great country should allow 6 percent of its manpower to remain idle and a quarter of its industrial resources to lie unused.

They thought this state of affairs reflected on the prestige of the leaders of the free world. I am wondering whether any of the central bankers and financial officials to whom you spoke expressed a concern about our level of unemployment and the extent of our underuse of resources.

Secretary ANDERSON. I think the great many of them talked to us in terms of, Do you believe that there has begun a real period of recovery? They were quite aware of the fact that we had gone through a recession; that we did have both unemployment and unused plant capacity.

The questioning to me was mostly along the line of, Has there been initiated a period of recovery which will last, and which will absorb the people who are unemployed and will the plant capacity not used, be used?

Representative REUSS. I am delighted to hear that the foreign officials to whom you talked had the same tale to tell as those to whom I talked. They were deeply concerned about unemployment, and concerned that we put the mass of our unemployed back to work. I would have hoped that you and Governor Martin would report the concern of these officials more fully.

Governor Martin, in his Chicago speech, gave the impression that foreign officials were concerned only with the fact of our budgetary deficit.

I believe that we have two jobs to do in this country—one, to combat inflation, and two, to combat the underuse of resources. To the extent that this view is shared by officials of foreign governments, it ought to be brought to the attention of the American people.

Secretary ANDERSON. I think that the Congressman would be interested to know that a great many people said to me that we are reassured by what you have said to us about the increase in the productivity and the return to prosperity.

You know, there is a time lag in the way statistics get around the world.

Representative REUSS. Another question, Mr. Secretary. I know what you are up against in finding enough revenue to cover Federal expenditures, to say nothing of retiring some of our staggering national debt.

I am particularly interested in your oil tax program this year; I don't suppose there is anyone in Washington who knows more about oil taxation than you.

In the program, you provide for a 1½-cent per gallon increase on the gasoline tax. Now that is a tax paid by the family on a Sunday outing, or the workman on his way to work, or the small businessman on his rounds.

I would like to ask why your administration, after 7 years, still hasn't done what its predecessor did? Why haven't you recommended to the Congress that we plug part of the 27½ percent oil depletion loophole.

Secretary ANDERSON. Congressman, I think one has to look at this problem of depletion first from a historical perspective; in other words, originally, the creature of the Congress in 1926, having for its purpose the development of a program of exploration, of discovery that would add to our oil reserves something more than the increase in demand from time to time.

It seems to me, historically, that this has worked out pretty well.

Representative REUSS. But at the moment however, aren't we in the position of having to keep out of the country some of the oil discovered overseas by American companies who took advantage of the 27½ percent oil depletion allowance?

Secretary ANDERSON. Let me follow along by saying domestically, in the last 3 years, we have not added as much to our domestic reserves as there has been increased demand.

I think one only has to look so far as the Suez situation to get a realization of the importance of this material from an economic and military point of view.

Now, there is another question too. I believe that over the years there has been a whole fabric of depletion written into the tax structure.

Each year, for many years, Congress has added something until we now have 40 or 50 different sort of things. It seems to me that in an examination into this principle, it should not be just an examination to a single commodity, but should be an examination into the whole fabric of the depletion system.

Representative REUSS. The Joint Committee on Internal Revenue Taxation of the Congress recently gave me an estimate that elimination of the depletion allowance for the oil industry, as well as for other extractive industries, would result in a $1.5–$2 billion addition to revenues for the Treasury.

I would very much hope that in these times of financial stringency, the Treasury would give the matter of adding to the Federal revenues its closest study, and I would appreciate your filing with this committee an extended answer to my question for incorporation into the committee record.

(The material referred to had not been received by the committee at the time the hearings were printed.)

I have just one more question: Generally speaking, it is held that long-term Treasury issues are less inflationary in their effect than short-term Treasury issues. Would you agree with that general principle?

Secretary ANDERSON. Well, I think generally so, primarily because the longer term securities are normally bought by real investors. They are bought by people who have pension funds or some amortized funds of that kind.

The shorter term investments more likely find themselves in the hands of the banking system, and therefore, more inflationary.

Representative REUSS. Isn't it also true that the shorter the term, the more nearly it is like money and the easier it is to convert it to cash and spend it?

Secretary ANDERSON. I think so.

Representative REUSS. In view of the President's strong instructions to all governmental agencies to operate their programs to contribute to stability, does the Treasury contemplate the issuance of a larger proportion of long-term securities?

Secretary ANDERSON. Congressman, I can answer that by saying we will issue long-term securities whenever we think we can market them at a reasonable price.

Now, there is a classical theory that you put out long-term securities in times of prosperity and that you put out short-term securities in times of recession. My own experience has been that no classical theory is ever wholly operative and that you put out long-term securities when you can. This is a problem that we are concerned about, as to whether or not part of the debt can be extended.

Representative REUSS. Then you intend to put out long-term securities whenever you can?

Secretary ANDERSON. Whenever we think the market will accept them.

Representative BOLLING. Senator O'Mahoney, did you have some questions?

Senator O'MAHONEY. Yes. Mr. Secretary, I know we all have to go and I don't want to take this time unduly, but two recent events have caused many inquiries to come to my office with respect to diesel fuel being imported into the United States, and some with respect to the abolition of the duty on wool brought in from Uruguay into the United States.

The story about the diesel fuel appearing in the papers the day before yesterday indicates that an American company, I think it is the Commercial Refining Co., is importing by hiring an Italian tanker, running Soviet diesel fuel from Rumania. This, of course, points directly at the policy of the Cabinet Committee with respect to the restraint of production so as to maintain, as far as possible, the capacity of the petroleum industry in the United States to continue to produce for the market.

I mentioned the other story about wool. Dealing with that now, all the way from Texas on the south, to Montana on the north, the woolgrowers are complaining and the wool manufacturers are also complaining.

Do you think that we should have an economic policy to prevent serious injury to American industry as appears to be the case in wool and oil?

Secretary ANDERSON. As the Senator knows, the Cabinet Committee is now working on additional programs with reference to the limitation of imports so as not to impair the capacity of the domestic industry unduly.

As to the specific shipment of oil to which the Senator refers, I am sorry I haven't read the story. I missed it in some way, and am not in a position to comment about it.

I do believe from the standpoint of the oil industry, that it is of sufficient importance to us both domestically, and certainly from the standpoint of national defense, that we have a dynamic, expanding, healthy industry capable of meeting our requirements in time of war or peace.

Senator O'MAHONEY. Are you aware that the State Department and the Defense Department have been asked to reevaluate the necessity of maintaining and keeping our production in the United States?

Secretary ANDERSON. Yes, sir; I am.

Senator O'MAHONEY. Do you think that will be carried through by the end of the month?

Secretary ANDERSON. I think so.

Senator O'MAHONEY. Would you say anything about the possibility of these wool growers and wool manufacturers having the opportunity, publicly, to present to the Treasury Department their point of view

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with respect to the danger they can see to exist from the withdrawal of this?

Secretary ANDERSON. Yes, Senator; this particular area of responsibility at the Treasury is under the jurisdiction of Assistant Secretary Flues, who is much more familiar with the details than I, although I will say that I have had calls from, as the Senator indicates, a great many of the woolgrowing States, and I know that Mr. Flues has sat down with a great many people to discuss it. The countervailing situation is one which, for a number of years, we have had a formula by which we measure the applicability of the countervailing duty.

The Uruguayan Government has, for a number of years, protested the countervailing duty and we have said to them the formula must be complied with.

They are now complying with the formula.

Under the rules that have existed for a substantial period of time, the countervailing duty would be removed.

Senator O'MAHONEY. Now, whether or not the formula has been changed, I don't know. Leaders in the wool industry say to me they believe the change has not been significant and the danger continues to exist.

My question was: Whether in your opinion there would be any possibility of arranging an open, public hearing where these people would appear before the proper person of your Department, to present their case to you. I mean publicly.

Secretary ANDERSON. Senator O'Mahoney, not knowing at this moment precisely when the effective date of the removal of the countervailing duty will go into effect, I can't say. But I will consider it.

Representative BOLLING. There being no further questions, Mr. Secretary, we wish to express our gratitude to you for your courtesy and patience.

The committee will recess until this afternoon at 2:30 p. m., when the witness will be Mr. Gerhard Colm.

(Whereupon, at 12:25 p. m., the committee recessed to reconvene at 2:30 p. m., the same day.)

## AFTERNOON SESSION

The CHAIRMAN. The committee will be in order.

Dr. Colm, we are very glad, indeed, to have you here. We appreciate your willingness to take the time to appear and present your views.

Proceed.

## STATEMENT OF GERHARD COLM, CHIEF ECONOMIST, ACCOMPANIED BY MANUEL HELZER, ASSOCIATE ECONOMIST, NATIONAL PLANNING ASSOCIATION

Mr. COLM. Thank you, Mr. Chairman.

It is, indeed, a great pleasure for me to respond to the request of this committee to present my views on fiscal and budgetary policy. I do so as an individual economist and not as a representative of National Planning Association with which I am connected.

I would like to use as a point of departure the "President's Economic Report for 1959" and the budget for the fiscal year 1960. In this connection, the testimony which has been presented to the committee this morning and on previous days has also been of benefit to me.

With your permission, Mr. Chairman, I would like, since I did sit in this morning, to make some comments at appropriate places about the discussion and presentation of this morning, if that is agreeable to you.

I will in this testimony raise some critical questions about the fiscal policies recommended in the "Economic Report." Such criticism, however, in no way conflicts with my appreciation for the high quality of the professional work reflected in the "Economic Report," particularly in the analysis and statistics of recent domestic and international economic developments.

If this meets with the wishes of the chairman, I will first discuss the employment and product goals for 1959, second, analyze the likelihood of accomplishing these goals under the fiscal and budgetary policies which have been proposed in various Presidential documents, third, discuss the threat of inflation, and, finally, venture some recommendations on fiscal and budgetary policy.

### THE EMPLOYMENT AND PRODUCTION GOALS FOR 1959

The report expresses confidence in the continued increase in production and employment. This same confidence is reflected in the revenue estimates of the budget. The report, however, makes no statement about the levels of employment and production needed to accomplish the objectives of the Employment Act. The discussion of the economic outlook in the report remains vague without any clear indication of the increase in employment and production needed to approximate "maximum employment, production, and purchasing power." In this respect, the report fails to live up to one of the important requirements of the Employment Act.

I may add here, Mr. Chairman, that this morning repeated reference was made to an alltime high in employment and production, that we can expect for this year and to the consequence for the threat of inflation and policy derived from that expectation. This demonstrates that it is not always useful to compare current or expected developments exclusively with the past. If the same developments were compared or were analyzed in the perspective of the needed levels of employment and production different conclusions would be drawn. I think this is an example of the usefulness of this provision of the Employment Act.

In view of this omission in the report it may be useful for the committee to have at least one economist's opinion on "the needed level" of economic activity. If an unemployment rate of 4 percent is regarded as compatible with maximum employment, I would estimate that approximately $500 billion GNP (in 1958 prices) would represent a full employment level of production by the end of 1959. For the year 1960 the corresponding figure could be about $520 billion, again in 1958 prices.

A reasonable case can be made that it would not be a practical goal of fiscal and economic policy to reach the maximum employment level in 1959, for to achieve this goal would require not only a continuation but a speeding up in the pace of recovery which we have had from the first to the fourth quarter of 1958. Furthermore, some of the present unemployment may be of a structural nature, having resulted in part from technological and managerial advances made during the last few years. Programs to facilitate readjustments in the labor force and especially in depressed areas may be needed in addition to a general rise in production if "maximum employment" is again to be attained. These readjustments require more time than is involved in a cyclical recovery of production. Therefore, a more reasonable goal for economic policy might be to achieve an increase in production which would bring us to the full employment level by 1960, if not in 1959. In the light of these considerations, I would regard as satisfactory a rate of increase in GNP which would bring us to the level of perhaps $470 billion for 1959 as a whole, or about $480 billion in the fourth quarter of 1959 (all in 1958 prices), provided there is reason to assume that the increase in production will continue into 1960 and that measures for promoting the needed structural adjustments are adopted. A $470-billion GNP (in 1958 prices) would leave us with about 5 percent unemployment in 1959.

That may not be desirable, but if it is the beginning of a long period of sustained considerable economic growth, it might be acceptable.

In any case, Mr. Chairman, whether you agree with my particular views or not I am convinced that some such discussion of reasonable goals, is useful and it is actually required of the Employment Act.

## THE ECONOMIC OUTLOOK

The "Economic Report" gives no estimate of what level of employment and production is likely to be reached under the forces of the market and in view of existing and recommended policies.

With this omission I have a bit greater sympathies because a forecast is more hazardous to make than a statement of needed levels. Moreover, the Employment Act is less stringent in this respect; it requires only a statement of "foreseeable" trends.

However, the Secretary of the Treasury has presented a forecast which is used for deriving the revenue estimates in the budget. According to his estimate GNP in 1958 would exceed $470 billion. The statement of this estimate did not indicate what if any part of this increase in GNP is expected to be due to a price rise. Assuming that the price rise would not be substantial during this year, the Treasury's forecast of the rise in production approximates what I would regard as a modest but reasonable goal for the rise in production over the average of the year, provided that the rise can be expected to continue and that adequate measures for combating structural unemployment are adopted.

What, then, is the likelihood that these employment and production goals can be accomplished with the fiscal policies recommended by the President?

This committee has heard testimony from various witnesses on the economic outlook. Some believed that a $470 to $480 billion GNP is likely to be accomplished; others apparently have some doubt. This goal could be reached if the rate of increase in production which we had from the first to the fourth quarter 1958 would be continued throughout 1959.

In the examination of the outlook, I will use, therefore, the factors which contributed to the economic recovery throughout 1958, and I will then ask what the likelihood is that these forces of expansion will continue into the future.

I would like to use this opportunity to make one comment on the statement made by the Secretary of the Treasury this morning in which he attributed the recovery, apart from the so-called automatic stabilizers, primarily to private behavior. If you simply look at the statistics of the tremendous increase in gross private domestic investment, then it is clear that this increase in the private sector of the economy is much larger than what happened to the public economy. However, I think this is only looking at the primary and derived factors in one aggregate. If we ask what were the factors which contributed to the recovery, I do think that the increase in Federal programs and particularly also the increase in residential construction due to measures adopted by Congress have played a primary role.

Therefore, in this respect I would think that not only the built-in stabilizers but also discretionary policies by the Government have played a larger role than was indicated by the Secretary this morning.

Among the factors which contributed to the rise in GNP during 1958 were three which are not likely to make the same contribution throughout 1959. First, there is the inventory swing from a $9.5 billion liquidation to a small accumulation of inventories. Even if there should be an inventory accumulation of $4 to $5 billion by the fourth quarter 1959 the contribution to the increase in production would be only about one-half of that experienced during 1958.

Second, Federal expenditures for goods and services increased by a rate of $3.6 billion from the first to the fourth quarter 1958. This made an important contribution to the recovery.

According to the analysis presented to this committee last week by Mr. Louis Paradiso, Federal expenditures for goods and services have about reached their peak and unless Federal programs currently contemplated are changed, these expenditures will not make a substantial further contribution to the rise in GNP.

Third, outlays for residential construction increased by a rate of $3 billion and reached record levels at the end of the year. At best, only a small contribution can be expected in this category during the next year, particularly if tight credit should handicap housing unless this tight credit would be offset, for instance, by secondary mortgage market policies or other measures. But I am doubtful if we can reckon with a substantial increase in residential construction over and above the end of the year level.

Other expenditures, namely those for consumer goods and outlays of State and local governments, rose during the year 1958 and can be expected to rise further by at least the same amounts.

And finally, there are those factors, such as business investment in plant and equipment and net exports, which did not rise during 1958 but which are likely to show some rise in 1959 and 1960.

If inventory accumulation, Federal expenditure programs, and residential construction in the aggregate should add $10 billion less to an increase in production through 1959, than they did through

1958, we must ask if it is likely that the increase, for instance, in consumption, or in State and local government programs, or in business investments in plant and equipment, and in net exports are likely to contribute a correspondingly larger amount than they did during 1958.

Some further rise in consumer expenditures and some increase in capital spending can be anticipated. The question is only whether the rise is likely to be large enough to offset the diminished force of our first category of expenditures.

The "Economic Report" underscores the considerable excess capacity which still existed at the end of 1958, and there is a very instructive chart on page 11 of the report demonstrating this. The report points out that present business plans indicate that contraction in capital outlays has come to an end. The report states that some upward revision in business plans for capital outlays may take place if economic conditions improve in general. This view was shared by several witnesses. However, I would not regard it as likely that the revision in business plans would be so drastic that capital outlays in 1959 and 1960 would repeat the upsurge which occurred in 1955 and 1956.

Some increase in net exports can be expected if economic expansion is resumed in the industrial countries abroad. However, the contribution cannot be very large and may become effective only after some time. This view is expressed in the "Economic Report." In the field of foreign trade the decline in net exports was not only a cyclical phenomenon but also reflected longer lasting structural changes in the balance of payments and international cost relationships.

My conclusion, therefore, is that reaching the $470 to $480 billion gross national product—in 1958 prices—is not impossible but is by no means assured under the fiscal policies which are recommended in the "Economic Report" and the 1960 budget.

The "Economic Report" takes a satisfactory rise in employment and production virtually for granted. Although several recommendations are made for long-range programs in support of economic development, budget allowances for these programs are extremely small, or, even in some cases, negative. There is a very good statement in the "Economic Report" on the importance of education for economic growth; in the budget you find an item of $42 million increase in expenditures for education for 1960 which in itself is not very large in the light of the needs.

But, Mr. Chairman, if you look through the budget document as a whole, you find under veterans' expenditures an item "Education and training" and here is a reduction by $129 million. So here you have in the "Economic Report" the statement very wisely pointing out the importance of education and of an increase in educational effort for long-term growth but the budget document as a whole does not implement this recommendation.

It is my impression that the real concern expressed in the "Economic Report" and reflected in the budget is with inflation.

By the way, I have been using the term "real" concern which was exactly the word used by the Secretary this morning.

My analysis, however, leads me to the conclusion that a satisfactory rate of growth cannot be taken for granted, even if modest goals are set for the immediate future.

THE THREAT OF INFLATION

The "Economic Report" appears to subscribe to the opinion that the threat of rising prices may originate both on the demand side (too many dollars chasing too few goods) or on the cost side (so-called cost-push inflation due to "administered" price and wage rate increases in excess of productivity gains). The fact that a reduction in budget expenditures is presented as a policy required to prevent inflation indicates the opinion that an excess demand is expected and that, therefore, a policy of fiscal restraint is necessary. On the other hand, the appeal of the President for restraint by business and labor in price determination and wage demands indicates the belief in the cost-push theory.

I want to make quite sure that I do not think holding these two views is inconsistent with each other. One can believe that either type of inflation can happen at various times or in combination.

A subcommittee of this committee has devoted a great effort to the study of this complex problem. Therefore, I will present my views very briefly omitting needed qualifications. There are available still substantial unused plant capacities and labor reserves. Therefore, we have still a long way to go before rising demand presses against scarce resources which would pull prices up. In other words, I do not believe that the danger of an excess demand is already in sight. This does not exclude the possibility that a price rise may be resumed after some time again. We should not forget that prices rose even during the recessions when there certainly was no excess demand.

To combat cost-push inflation effectively by fiscal and monetary policy would require measures so drastic that the remedy would probably be much worse than the disease. A somewhat milder restrictive fiscal and monetary policy might not be adequate to halt the rise and cost rise and yet would probably impede a desirable rate of economic growth.

The CHAIRMAN. You changed the word "certainly" to "probably."

Mr. COLM. Yes, sir.

This committee has heard several witnesses raise the question as to whether the budget for the fiscal year 1960 makes adequate allowances for national defense in the broadest definition for stimulating economic development in underdeveloped countries for science, research, education, training, conservation and development of resources, urban redevelopment and for promoting needed structural adjustments in the country, including aid to the depressed areas.

Viewing these programs in the light of both the critical international situation and the urgent needs which we face at home, I am personally convinced that a greater effort in several of these programs is needed. Present budget restrictions make sense only if one assumes that we cannot afford a greater effort or that a greater effort in these programs though desirable would lead to inflation and that preventing inflation should be regarded as the highest priority objective. A discussion of a need for a greater effort in the present world situation may exceed the competence of the economists. However, I believe it is incumbent on the economists to stress with all possible emphasis that we have the productive resources for a greater effort and that the present and foreseeable economic situation does not justify the need to limit high priority programs in order to prevent demand inflation.

The report makes no recommendation on monetary and credit policy except by referring to "the pursuit of appropriate monetary, credit, and debt management policies."

I regard this as another omission, which is not in accord with the intent of the Employment Act.

The "Economic Report" makes recommendations to the Congress, to business, to labor, to State and local governments, and to the consumers. Now, they all are certainly not depending on the executive branch. Yet recommendations are made. Only the one area of credit and monetary policy is left out, except for the one phrase which I quoted.

From the concern expressed by the administration with inflation and from expressions of opinion by members of the Federal Reserve Board, one might guess that "appropriate monetary and credit policy" means in this context a restrictive credit policy.

Thus if combating the threat of inflation is given first priority in the formulation of fiscal and monetary policies, we may fail to reach a reasonable objective of economic growth. I am referring again to the $470 to $480 billion GNP in 1959 and to the $500 and $520 billion in 1960.

Addressing myself specifically to the 1960 budget, I would not quarrel with the revenue estimates and the underlying economic assumption but wonder if these assumptions and the related revenue estimates are consistent with the expenditure policies of the budget and the monetary policies which appear to be in store.

SOME CONCLUSIONS ON FISCAL AND BUDGETARY POLICIES

The revised 1959 budget figures indicate a $9 and $11.5 billion increase over 1958 in the expenditures of the administrative and cash budget respectively leaving about a $13 billion deficit in either account. The 1960 budget recommends a reduction in expenditures from the 1959 budget by $3.9 billion and $2 billion in terms of the administrative budget and cash payments respectively. Both accounts show a small excess of receipts over expenditures.

This committee is aware of the fact that some of the reductions in expenditures do not represent real program reductions but result from sale or exchange of financial assets and other bookkeeping procedures.

I remember that Congressman Patman asked some questions——

The CHAIRMAN. Dr. Colm, are there any other instances involving the sale of assets besides the sale of $335 million of mortgages?

Mr. COLM. There are about $600 million in sale of assets of various types of mortgages and of loans held by the Export-Import Bank.

The CHAIRMAN. The Export-Import Bank?

Mr. COLM. Yes.

The CHAIRMAN. In other words, the sale of $600 million is in addition to the sale of $335 million by FNMA?

Mr. COLM. The FNMA is $335 million, the college housing loans is $50 million, the Exmbank loans, $234 million.

The CHAIRMAN. I see.

Mr. COLM. For a total of $619 million.

The CHAIRMAN. Thank you very much.

Mr. COLM. Without these special transactions the budget would show a deficit instead of a surplus.

Mr. Chairman, this morning it was said that the budget balance is the cornerstone of our fiscal soundness. I have the feeling that this corner consists more of quicksand than of stone. Also, the Government's guarantee and insurance programs which are not reflected in either the administrative or cash budget are likely to have a similar effect on demand as programs reflected in the budget. While the net budget expenditures for the major Federal credit programs in 1960 show a reduction of $4 billion below the 1959 budget, estimates for loan guarantees and insurance are scheduled to increase by $3.3 billion. So you have a reduction for the same programs inside the budget and an expansion in the corresponding items outside the budget of $3.3 billion. This indicates that a mere comparison of budget expenditures and budget balance from year to year does not tell the full story about the economic impact of Federal transactions. Considering not only the conventional budget but also the trust accounts and the guarantee and insurance programs and making allowance for possible increases in the cost of Government services and products, I would guess that on balance the Federal programs as proposed in the 1969 budget imply approximately a continuation of present levels of activity.

This, by the way, is based on expenditure estimates; at least for the longer lead items in the defense area we should also look at the obligations which reflect contracts. Perhaps I might mention that in defense procurement, expenditures are scheduled to rise by $200 million but the obligations which reflect contracts let are scheduled to be reduced by $600 million.

However, a conclusive judgment would require more study of the budget document than I have been able to do during these last few weeks. Nevertheless, I think it is safe to say that the budget in 1960 represents at least a leveling off in Federal Government outlays and that would mean that these programs will cease to make a positive contribution to further economic expansion during the year 1959.

In spite of the existence of substantial unused resources, both human and material, I would not recommend the adoption of a broad anticyclical expenditure program or tax reduction at the present time. I would, however, recommend that the Congress examine the various high priority expenditure programs on their merits. If after evaluating national priority requirements, program revisions should result in a relatively small increase in expenditures for fiscal year 1960, let me say something of the order of magnitude of $2 or $3 billion, I would not believe that an increase in taxes would be needed to counteract a threat of inflation. If, however, the international situation should require a much larger increase in expenditures, then I do believe that an increase in taxes should be considered.

I agree with those witnesses who have recommended tax revisions even if no general tax increase should be needed. I personally believe it would be highly desirable if some of the unrealistic top tax rates on individual incomes would be lowered and if loopholes and exemptions in individual income and estate taxes could be reduced. That would result in a net increase of yield.

A general increase in tax rates under present or even slightly increased programs would, in my opinion, impair the chance of achieving a desirable rate of growth. We should aim at the budget balance or a budget surplus in years when demand has risen to the point where scarcities appear and tend to drive prices up. This situation has not yet arisen, and is not in sight.

An apprehensive driver who steps on the brake as soon as the peak of the road becomes visible on the horizon may never make the peak. I admit this matter of timing is a very difficult one in driving and in formulating a budget. The decision will depend in the last analysis on the appraisal of the risks involved in either stopping too early or stopping too late.

Under present conditions I feel that greater than the danger of demand inflation is the danger that a too restrictive fiscal and monetary policy may prevent us from using our productive resources for the urgent tasks which must be fulfilled. In a critical period of competitive coexistence, a free and democratic society can survive only if it proves its worth by superior performance.

The CHAIRMAN. Thank you very much, Dr. Colm, for your paper. It was very interesting. Congressman Bolling?

Representative BOLLING. Dr. Colm, there are many questions that I would like to ask in the way of expansion on specific points, and otherwise, but I am much intrigued by two "provides" that appear in your statement.

You say:

> In the light of these considerations I would regard as satisfactory a rate of increase in GNP which would bring us to the level of $470 billion for 1959 as a whole or about $480 billion in the fourth quarter of 1959 (all in 1958 prices) provided there is reason to assume that the increase in production will continue into 1960 and that measures for promoting the needed structural adjustments are adopted.

then:

> Reasonable goal for the rise in production over the average of the year, provided that the rise can be expected to continue and that measures for combating structural unemployment are adopted.

I do not want to put words in your mouth. But do I gather that this means that you think that it is possible that we will reach this reasonable level of production of $470 to $480 billion in this year and then perhaps just level off or flatten off?

Mr. COLM. Mr. Bolling, I think there is a possibility that that might happen, and I think present policies should aim not only at 1959 but should aim also at giving support to economic growth beyond that period. I think it is more important to embark on sustained economic growth than to push now as far as we can and then perhaps relax afterward.

Representative BOLLING. Then, if I correctly assess the meaning of your whole paper it is that, in effect, the present policies are attempting to meet a situation that does not really exist, that is, an inflationary situation that does not really exist at present, and that those policies may or may no achieve even a very modest increase in growth, in this particular year. They may or may not achieve full employment but they certainly do not give any hope of a continuing modest growth.

Mr. COLM. Yes, sir.

Representative BOLLING. I will pass.

The CHAIRMAN. Congressman Reuss.

Representative REUSS. Thank you, Mr. Chairman.

Dr. Colm, you point out that the report unfortunately makes no reference to the kind of monetary and credit policy which the President and his economic advisers think we ought to have. However, it is a fact, is it not, that for some months now the Federal Reserve has been applying a so-called restrictive monetary policy.

Mr. COLM. Mildly restrictive, yes, sir.

Representative REUSS. Perhaps you can recall for me just what the Federal Reserve has done. Did the increase in the rediscount rate occur in November?

Mr. COLM. They increased the discount rate I think in October. On October 24 there was an increase from 2 to 2½ percent. That was on October 24.

Representative REUSS. Could the three kinds of Federal Reserve monetary policies be distinguished as restrictive, expansionist, and neutral? Will you accept that rough categorization?

Mr. COLM. Yes, though I think neutral is more a line than the category.

Representative REUSS. More a line than——

Mr. COLM. It is just a line, a sharp line more than a broad category.

Representative REUSS. Yes.

I know from your testimony that you think a restrictionist policy is not well advised at the present time. Do you believe that an expansionist monetary policy is preferable to a neutral monetary policy?

Mr. COLM. I think I would still prefer a mildly expansionary credit policy.

Representative REUSS. Thank you.

I would like to discuss further the the question raised by the chairman on the proposed sale of assets by the FNMA and the Eximbank.

As I understand it, it is proposed that the Eximbank, which now has in its portfolio loans of varying maturities, offer these for sale. Won't this practice prove to be expensive for the taxpayers? First: At present with rising interest rates, long-term securities issued when rates were lower, are subject to large discounts. They are selling not at par or at premiums, but at 90, 80, or 70, depending on the quality of the loan.

Is it fair to the American taxpayers to sell assets at a time when the price of assets is relatively low? Would the taxpayer not be best off if they were held either to maturity or until the market for investments is more favorable?

Mr. COLM. Yes; I think that might be.

In the case of the mortgages, I am not quite sure what "sale" really means here because the way I understand it, in part it is intended as swapping Government bonds for mortgages. There are financial institutions holding certain Government bonds which now have value below par. I think the idea is to exchange these bonds against some of the mortgages.

Now, since both mortgages and bonds are below par I do not know quite how we come out because they are below par on both sides of the balance sheet. Insofar as the financial institutions are taxpayers, which is not true for all of them, they have a gain because they will realize a capital loss for tax purposes, without really having to take a loss on the substance of their capital.

Mr. Reuss, I did try to get a little bit more information about that; but I am still pretty much in the dark and was very happy to see that the Secretary of the Treasury was asked this morning to provide more information for the record. My impression is that it has not yet been spelled out quite in detail as to how it will be done.

Representative Reuss. I certainly think a more detailed story is necessary. If the Eximbank must sell paper, let us say, due in 3 years, 80 cents on the dollar—at a sheriff's sale price—rather than wait the 3 years to collect 100 cents on the dollar, it is not a very good deal for the taxpayers.

Second: the Exim fund is a revolving fund. During the last 2 or 3 years, a third of a billion dollars net, have been added each year, in order to expand the loan program. In this year's budget, I notice that the Government, far from putting money into the Eximbank, actually plans to withdraw $6 million.

Mr. Colm. $6 million. It is a reduction by $250 million from last year.

Representative Reuss. Yes, sir. Now, doesn't this defeat the principle of a revolving fund? If you hock its assets, isn't it going to cease to revolve; and isn't the taxpayer going to have to dig very deep into his pockets in a couple of years to compensate for the sale of the assets this year? Is that a fair statement of what would happen?

Mr. Colm. I think so, Congressman Reuss.

If I may make one comment, which has occurred to me this moment, if I am not mistaken the same transaction in Great Britain would appear under the line and would not affect the operating budgets or a deficit. This leads to the whole question of how certain capital transactions should be treated in the budget. I feel this is a demonstration that having in the budget operating figures and such capital transactions all in one aggregate and then adding them up with whatever net comes out, in this case for the Eximbank a plus of $6 million, that that really does not make much economic sense. Perhaps some other budgetary arrangement would be preferable. If such capital transactions are only shown below the line they would not affect the budget results. This would assure that such transactions are made only if they are desirable on their own merits and not used just for influencing the budget balance.

Representative Reuss. I have a final question. Toward the end of your paper, you discuss the possibility of increasing the most imperative expenditures to the order of $2 or $3 billion, and you state—

> I would not believe that an increase in taxes would be needed to counteract a threat of inflation.

You say later that you agree with those who think this is a good time to close tax loopholes—and I certainly want to be counted in this group—even though incurring a $2 billion deficit would not, in your opinion, add appreciably to inflationary dangers because of the slack in the economy.

Don't you think that there is no better time than the present to close some of these tax loopholes? We could avoid running a deficit and even, possibly, start repayment of portions of the national debt to reduce the lerge annual national interest burden on the national debt. Don't you think this might be good governmental policy?

Mr. COLM. Mr. Reuss, I think improving the structure of the tax system, from both an economic and equity point of view, is always a desirable objective. I would not recommend doing it at this moment in order to put a damper on private purchasing power. That means from a cyclical point of view, I do not think that absorption of purchasing power is a desirable policy when we are still running 25 or 30 million below a maximum employment level.

Representative REUSS. Yes, but aren't there numerous tax loopholes, the plugging of which would not result in diminished purchasing power?

Mr. COLM. I think that is true, Mr. Reuss, and this raises, of course, this whole question whether a small budget surplus or budget deficit in itself is either inflationary or deflationary. I think this morning some figures were quoted showing that we had a price rise at times of budget surplus and price reductions in periods of deficit. I think you are quite right. We should look at the likely effect of the changes, both on the expenditures and tax side and it might be that some closing of loopholes may have very little detrimental effect on purchasing power.

When you said, is this not the best time to have the surplus, then I only can say perhaps it is if the budget surplus is achieved by measures which do not negatively affect purchasing power; then it would do no harm, but I do not think this is a particularly good time for using increases in taxes for dampening purchasing power. I think we need more growth.

Representative REUSS. I surely agree with you on that last remark. Thank you very much, Dr. Colm, and I thank the chairman.

The CHAIRMAN. Mr. Bolling, have you another question?

Representative BOLLING. I would like to find this out. Could somebody tell me what the national debt was in the year 1948? Do we have that somewhere?

Mr. COLM. $252 billion—$253 billion.

Representaive BOLLING. Now, looking at page 2 of the current economic indicators, one hears a great deal about the overriding danger of the national debt. Looking at page 2, $252 billion was the national debt.

Mr. COLM. $252.9 billion.

Representative BOLLING. That was in 1948?

Mr. COLM. Yes, sir.

Representaive BOLLING. I note that on page 2 of the current economic indicators the GNP in 1948 was $259.4 billion and today the national debt is——

The CHAIRMAN. $283 billion.

Representative BOLLING. $283 billion and the GNP—I do not know.

The CHAIRMAN. $440 billion or——

Representative BOLLING. $440-some.

The CHAIRMAN. $455 billion.

Representative BOLLING. $455 billion.

Well, in your opinion, Dr. Colm, is the present size of the national debt from an economic point of view, from the point of view of the health of the economy, a matter of very serious concern? I recognize it has many significances, but I mean is it a real threat to the survival of the American economy?

Mr. COLM. My answer would be definitely no, but only because you gave in your question the necessary qualifications. It is not a threat to the survival of the American economy, but it has great significance for many of our policies. It is something to be reckoned with. Therefore, I would say it is not a threat but it is something of which we ought to be aware, particularly in connection with credit policies. Of course, it depends on who owns it, and many other factors of which you are well aware.

Representative BOLLING. Its real significance, then, is in how it is handled?

Mr. COLM. How it is managed.

Representative BOLLING. Thank you, Dr. Colm.

The CHAIRMAN. Dr. Colm, I have been on the floor of the Senate much of the day and there has been a running fire debate over there, the gist of which from one side of the aisle is that whenever you have a Government deficit this, of necessity, creates inflation and a rise in the general price level. I wondered if you would analyze that statement briefly. Under what conditions might it be true and under what conditions might it not be true.

Mr. COLM. Senator, first, the historical record speaks against that notion, that there is a mechanical relationship between deficit and price level. That statement is not borne out by any facts. And I think, also, a theoretical analysis would not suggest any mechanical relationship.

First, the price rise or price fall is the result of many factors in the economy. From that point of view, the issue of stock by corporations or private consumers going into debt has exactly the same effect on the price level as the spending and receipts of the Treasury. So it certainly depends on every other factor.

We are having now a deficit, the largest in peacetime and we have a relatively stable price level, because of the other factors in private consumption and business investments.

In other periods when you have a great upsurge in consumer buying on credit, and business investment financed by outside capital, if in such a period the Government incurs a deficit, it may add to the inflationary pressure, as was the case at the outbreak of the Korean scare buying period and as we certainly had during the period after the end of the Second World War.

The CHAIRMAN. Dr. Colm, suppose the deficit (*a*) is of an appreciable size and (*b*) is financed either by an issuance of paper money by the Government or by the creation of demand deposits by the banking system and then suppose, (*c*) with velocity of credit constant but with an increase in the quantity of the monetary medium greater than the increase in physical production. Under those conditions you will get a rise in prices, is that not true?

Mr. COLM. We have a rise in prices which may not last, whether it lasts or does not last depends on the responsiveness of supply because if there is idle capacity——

The CHAIRMAN. I understand.

Mr. COLM. We may have a small price rise but we get more production.

The CHAIRMAN. I am saying that if velocity is constant and the increase in the quantity of the circulating medium, whether money or demand deposits, is greater, or at a greater rate than the increase in production or the quantity of goods and services to be exchanged, under those conditions you will get a rise in prices, would you not?

Mr. COLM. Yes.

The CHAIRMAN. If the increase in the production of goods and services keeps pace with any increase in the quantity of money and credit then the two cancel each other out roughly and the price level will be relatively steady, is that not true?

Mr. COLM. Yes, only——

The CHAIRMAN. Then assuming velocity to be constant——

Mr. COLM. Senator, you said assume velocity is constant. Now, I agreed with your statement——

The CHAIRMAN. Yes.

Mr. COLM. But I think before you reach a final conclusion you also want to examine your assumption.

The CHAIRMAN. I understand. I was using logic rather than history, so to speak.

Now we had some puzzling behavior in 1955, 1956, and 1957, as I remember it, roughly. There was not a great increase in the quantity of demand deposits and currency, not a great increase, but there was some increase in prices during that period which could only be explained under the quantity theory of money by an increase in velocity. Is that not true?

Mr. COLM. Yes.

The CHAIRMAN. Do you think that the rise in the interest rate contributed to the increase in velocity? The interest rate was increased in order to dampen down the increase in the quantity of credit but it has occurred to me that by making the holding of inventories more costly it may actually have speeded up the turnover of goods and increased velocity and, therefore, while the Federal Reserve was guarding the front door against an increase in the quantity of the circulating medium, in through the back door may have come the increase in velocity, and, hence, the rise in price levels. Now that is purely a surmise. Do you have any opinion on that, sir?

Mr. COLM. No, I have not.

The CHAIRMAN. Would it be interesting to run it down?

Mr. COLM. It is a very intriguing hypothesis that I would like to see tested.

The CHAIRMAN. You have a very sharp mind on that question.

Now I would like to ask some questions on debt management, if I may, if this is a subject in which you have prepared yourself.

Mr. COLM. Very little. I do not claim to be an expert on that.

The CHAIRMAN. I would have asked the Secretary and his assistant but the time for questioning had passed.

Had you followed the handling of the debt at all?

Mr. COLM. Not closely, Senator.

The CHAIRMAN. Has your assistant?

Mr. HELZNER. No, not on that score.

The CHAIRMAN. I would like to find out what margin, if any, is required on the purchase of Government bonds and particularly short-time Government payment. Do you know that?

Mr. COLM. I did not get that.

The CHAIRMAN. What margin do the people who buy or the traders who buy Government bonds have to put up, if any?

Mr. COLM. Well, Mr. Helzner has whispered 5 percent in my ear. I remember the current issue of Fortune magazine has a very constructive article, and I think they do say that as a matter of practice a 5 percent margin is used.

The CHAIRMAN. The margin on stocks is 90 percent now.

Mr. COLM. Yes.

The CHAIRMAN. The margin on Government bonds is 5 percent?

Mr. COLM. I think so, at least as a matter of practice.

The CHAIRMAN. Has that 5 percent always prevailed?

Mr. COLM. My information comes from a Fortune magazine article and that was my impression, that that margin is not being changed.

The CHAIRMAN. This is a very interesting question.

The Secretary this morning mentioned and his assistant mentioned the desirability of checking speculation in Government bonds or reducing speculation in Government bonds. That is more accurate.

Now one way of reducing speculation in stocks is to increase the margin. Have you given any thought to the possibility of increasing the margin on the purchase of Government bonds?

Mr. COLM. No, sir. I have heard the argument but also I am convinced the market for Government bonds is different. You have just a handful of dealers.

The CHAIRMAN. The stocks are much more risky, for example, than Government bonds, and, therefore, need a wider margin.

Mr. COLM. Here you have a large professional group dealing with Government securities, and I think the situation is not quite comparable to that of stocks.

The CHAIRMAN. I spent several days in the so-called open market room of the New York Federal Reserve Bank, which is the fiscal agent of the Treasury, and which also manages the open market accounts for the Federal Reserve. In the purchase and sale of Governments on the reserve account the bank dealt with each trader individually. Each specialist would have a separate telephone, and the connection was with the group or the trader at the other end of the wire, but there was no central floor or place to deal.

Would you think that possibly the open market operations should be conducted on the model of the New York Stock Exchange?

Mr. COLM. I believe the Chairman is much better informed than I am. I have no opinion.

I would like, before we are through, to make one more comment.

The CHAIRMAN. Yes.

Mr. COLM. At an appropriate time, I would like to comment on an aspect discussed by the Secretary of the Treasury this morning.

The CHAIRMAN. Yes; I would like to have you mention that.

Mr. COLM. Listening to the Secretary I found there was one underlying theory in his position with respect to the threat of inflation. I leave aside what talking about that threat did last summer; I think it had something to do with the drop in the Government security market and the stock market boom. Too much scare talk about inflation was not always without consequences.

The CHAIRMAN. May I interrupt there?

Mr. COLM. Sure.

The CHAIRMAN. I wanted to say this to the Secretary but we did not have time. I hope it will be proper for me to say it now.

Let me say that I believe in people being permitted to say what they think, and that this applies to governmental officials as well as to citizens and Congressmen.

I did somewhat smile a few years ago in 1955 when some of us felt that the stock market had risen probably too rapidly and we proposed an inquiry into stock market prices, and I can well remember Secretary Humphrey coming down, and, in effect, denouncing us in the coldest and most icy terms for, as he said, spreading scare talk that stocks might be too high and that, therefore, we would be depressing the stock market.

I resented that at the time, and I do not want to be guilty of a similar charge now.

I want to say that I think this was not part of the purpose of the administration in any respect. But is it not true that the talk of inflation, that the dollar was going to be worthless, prices would rise, purchasing power of money would fall, and that, therefore, Government bonds would have smaller purchasing power in the future, did not that of necessity depress the prices of Government bonds?

Mr. COLM. I think that was a factor in the collapse of the market last summer but——

The CHAIRMAN. And helped to lead in an increase in the price of stocks?

Mr. COLM. The price of stocks, the price of real estate, farms, and other inflationary hedges.

The CHAIRMAN. Very frankly, if I might offer in absentia to the Secretary and to the administration this word of caution: I think they should be very careful about excessive talk about the dangers of inflation because the effect is to depress the prices of Government bonds. If they believe this is an actual danger they, of course, should go ahead, just as I think we should go ahead on stock market prices. But since the administration insisted that we must obsesrve caution about the prices of stocks I think Congress has the right to suggest to the administraion that they should observe cautious talk about inflation and the depreciation of the value of bonds because psychologically they may help to bring about the very thing against which they are supposedly guarding. I think perhaps we should find a courteous way of conveying these sentiments to Secretary Anderson.

Representative BOLLING. We will send him the transcript.

The CHAIRMAN. What?

Representative BOLLING. We will send him the transcript.

The CHAIRMAN. All right.

Mr. COLM. Senator, it was my impression that in response to various questions of the future of economic growth the following theory was developed: Now, we have as a threat to economic growth the fear of inflation. If we can assure people by a balanced budget that the dollar will be held stable absolutely then more savings will be forthcoming, more savings will mean more capital formation. More capital formation means economic growth. I think that was the underlying theory. Now, I had to look again at this chart in the Economic Report, according to which we are still 20 percent below capacity, and in that situation I do think that economic growth must be stimulated at least by another process in addition to the confidence factor which in itself I would not deny. That we had such a discrepancy between increase in manufacturing capacity and increase in manufacturing production, as is demonstrated in that graph, had in my opinion something to do with the drop in investment in plant and equipment. Therefore, I do think that rising demand and production will lead to more expansion, particularly if at the same time advances in research make new investments attractive. Economic growth must be stimulated from the demand side, while at the same time I do not deny that a real threat to inflation which does not exist, but if it existed could create trouble.

The CHAIRMAN. Just one final point I want to make before I turn the questions back to Mr. Reuss and Mr. Bolling.

I know how careful and cautious you are in making your statements, and I want to say I think you are one of the very best witnesses who appear before us. We, however, should be cautious on this question of unused capacity in my judgment because if you put all the unemployed workers to work on idle capacity, the 6 percent unemployed, you would still have 18 percent idle capacity. In other words, the so-called idle capacity is at the moment about 25 percent, so that that would be around 18 percent of it idle even if you had completely full employment, and, of course, this is an almost unattainable goal. Three percent unemployment is, I think, the lowest to which you can go except in times of war. You accept 4 percent. So we need to be careful when we say we can increase output 24 percent by putting everyone to work.

Mr. COLM. Yes.

The CHAIRMAN. There are lots of contradictions inside that figure.

Mr. COLM. Yes.

The CHAIRMAN. I think we should be careful.

Congressman Bolling?

Representative BOLLING. I have no more questions.

The CHAIRMAN. Congressman Reuss?

Representative REUSS. I have no questions.

The CHAIRMAN. Thank you very much, Dr. Colm.

Tomorrow we meet here at 10 o'clock, and the chief witness is William McChesney Martin, Jr., Chairman of the Federal Reserve Board.

In the afternoon there will be a critique by a Prof. Seymour E. Harris, chairman of the department of economics, Harvard University. The meetings will be held in this room.

Therefore, the committee will stand in recess until 10 a.m. tomorrow morning.

(Whereupon, at 3:50 p.m. Thursday, February 5, 1959, the committee recessed to reconvene at 10 a.m., Friday, February 6, 1959.)

# JANUARY 1959 ECONOMIC REPORT OF THE PRESIDENT

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FRIDAY, FEBRUARY 6, 1959

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met at 10 a.m., pursuant to recess, in room 457, Senate Office Building, Hon. Paul H. Douglas, presiding.

Present: Senators Douglas, Bush, Javits; Representatives Patman, Bolling, and Kilburn.

Also present: Representatives Joseph W. Barr, of Indiana; Representative Charles H. Brown, of Missouri; Roderick H. Riley, executive director; and John W. Lehman, clerk.

The CHAIRMAN. The committee will be in order.

If you are ready, Mr. Martin, you may proceed.

## STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, ACCOMPANIED BY RALPH YOUNG, DIRECTOR, DIVISION OF RESEARCH AND STATISTICS, FEDERAL RESERVE SYSTEM

Mr. MARTIN. Thank you, Mr. Chairman.

Last year, when I testified before your committee on behalf of the Federal Reserve Board, economic activity in this country was receding. Contraction in output and employment was general. Unemployment was rising at a disturbing pace. No one could be sure how far downward adjustment would go, or how long it would last.

We pointed out then that, with the exception of the catastrophic recession of the thirties, every moderate cyclical decline since World War I had been checked in the course of a year. It was further emphasized that many forces were present in the economy that were favorable to eventual recovery. But at that time we did not know, nor did we then expect, that vigorous recovery would so soon be in full swing, and that contraction from 1957 levels of activity would be shorter in duration than most preceding economic recessions.

Even while the committee's hearings were going on, some were beginning to view the outlook more optimistically. In January, corporations, taking advantage of easier conditions and lower interest costs in financial markets, were offering an increasing volume of new issues in anticipation of future needs for funds, and to refund shorter-term debt. State and local governments were bringing to market bond issues that were deferred earlier, and were stepping up the pace of bond offerings to provide for public works.

Farmers continued to foresee favorable output and price conditions in agriculture and were bidding up further the prices of farm land.

Bankers, with slackened customer demand for credit and with strengthened reserve positions, were bidding more aggressively for assets. By February, bankers were accelerating expansion of the assets and deposits of their institutions, thus increasing more rapidly the economy's stock of cash balances and raising its overall liquidity.

Within a matter of weeks following last year's hearings, personal income and consumer spending had ceased to decline and, in fact showed modest recovery. Production and employment soon after resumed an upward trend. Whether these developments, though encouraging, foreshadowed wide revival in activity was not known at the time; not until the June-July period did the current flow of information and reports provide substantial confirmation that general economic recovery was actually underway.

But from that stage on, currently available data, reflecting trends in markets, production, and employment, showed that recovery was both broadly based and vigorous. Pickup in employment, however, lagged behind that of output as is usual in early phases of cyclical upswing. At the year end, 8 months after recovery set in, the level of total output in the economy approximated that prevailing at the output peak of 1957.

Recovery has been so rapid and widespread as to indicate that the revival phase of the economic cycle has by this time probably run its course. The economy has reattained its prerecession level and now appears to be entering a phase of resumed economic growth.

## FEDERAL RESERVE ACTION TO COMBAT RECESSION

This brief review of changing levels of economic activity during 1958 provides a backdrop for specific comments about Federal Reserve policy and action over the past 16-month period of recession and recovery.

As reported to you last year, Federal Reserve policy began to shift in a counter-recession direction in late October and early November of 1957. About that time, the System directed its open market operations to supplying reserves more liberally to the banking system. It also reduced the discount rates on member banks borrowings from the Reserve banks. As the stream of factual information verified the emergence of recessionary trends, Federal Reserve actions and policies became more aggressive and discount rate, open market, and reserve requirement instruments were actively applied in complementary fashion to foster ease in credit markets and encourage bank credit and monetary expansion. From late fall 1957 through April 1958, there were four reductions in Federal Reserve bank discount rates, from 3½ percent to 1¾ percent. Through continuing open market operations from late fall of 1957 to early last summer, the Reserve System supplied the commercial banks with some $2 billion of reserve funds. Through three successive reserve requirement reductions in late winter and early spring of last year, the System released for the use of member banks about $1.5 billion of their required reserves.

The total amount of reserve funds supplied by the System to commercial banks over the 9 months, November 1957 to July 1958, was enough to enable member banks to reduce their discounts at the Reserve banks form $800 million to about $100 million, to offset sales of gold to foreign countries amounting to about $1.5 billion, and to finance a commercial bank credit expansion of almost $8 billion. Monetary expansion from February through July stimulated by this Federal Reserve action was at an exceptionally rapid rate—at an annual rate of 13 percent for all deposits, including time and demand deposits. For the active money supply; that is, demand deposits and currency seasonally adjusted, the rise was at an annual rate of 8 percent. After the shift in Federal Reserve policy in the summer, expansion in the active money supply slackened, and for the year as a whole it amounted to about 3½ percent.

### BROADER EFFECTS OF MONETARY ACTION

Although the immediate impact of Federal Reserve policy was on commercial banks, it clearly had broader effects upon the economy generally. For one thing, since commercial banks are direct participants in some degree in all important credit markets, expansion in bank lending and investing activities intensified competion among all lenders for the acqusition of the available supply of credit-worthy loans and securities. This worked to reduce the cost of financing to borrowers generally—businesses, farmers, consumers, and home buyers, and all levels of Government. It also widened access of all potential borrowers to credit funds.

Another effect of the credit ease was a greater willingness on the part of banks and other lenders to make new loans to business customers and to renew outstanding credits. This facilitated the orderly runoff of excess business inventories accumulated in the preceding boom. It also furthered the completion of business programs of plant and equipment expansion begun in that period. With a $6 billion reduction in business inventory holdings and a significant cutback in fixed investment programs since recession began, it is perhaps remarkable that business loans outstanding declined only $1½ billion in the year ending September 1958. The ability of businesses to maintain their bank borrowing and also to borrow more readily in capital markets not only cushioned downard pressures on investment spending but helped many companies to minimize cutbacks in their working force and payrolls, to maintain dividends, and to strengthen their liquidity positions.

In housing markets, the easier conditions broadened the availability of mortgage funds. Discounts were reduced on FHA and VA mortgages subject to ceiling interest rates, and interest rates on new conventional mortgages also fell. As bank credit expension gained in momentum, banks participated in mortgage investment more actively than at any time since the boom housing year of 1955. The increased availability of mortgage funds at lower cost, together with the maintenance of personal income, was promptly reflected in a step-up of builder activity in constructing new houses.

In the consumer instalment credit area, the increased availability of funds made it possible for lenders to meet sound demands for credit more readily, thus bolstering lagging demand for consumer durable goods. On some transactions, terms were eased and, in addition, new credit plans were developed and extended. Easier credit conditions permitted lenders to be more liberal in granting renewals and extensions of time for repayment of outstanding credit. Thus, the volume of repossessions and credit losses was less than would otherwise have been the case, with benefits to both borrowers and lender.

Increased availability of funds also had an important impact on State and local government financing and spending. In many cases, the lower cost of financing encouraged States and municipalities to borrow in order to finance capital projects. In a few cases, lower market rates enabled local governments that had a legal ceiling on permissible interest rates to return to the market. The increase in spending by State and local governments from the summer of 1957 to the summer of 1958 was a billion dollars more than in the corresponding period of the preceding year.

These observable effects of easier monetary conditions which developed from efforts to combat recession were, of course, important and salutary. They are not to be overly stressed, however, for monetary action is always only one element in Government counterrecession policy. In turn, Government policy is always only one element in the total economic scene. Businesses, individuals, and State and local governments, in the light of their own circumstances, were taking actions to adjust and adapt their situations and to redirect their energies. Their actions undoubtedly shaped the recovery and gave it momentum.

CHANGING EXPECTATIONS

Achievement of monetary ease to combat recession so promptly and amply was not without its problems. One of the most acute was the buildup of prices in the bond market as speculators counted on continuing business recession, credit ease, and still higher bond prices. Psychological reactions and expectations always play a role in swings in economic and financial developments, but were of particular importance in financial markets last summer as the economic outlook changed from one of a continuing recession to one of early, vigorous recovery.

At that time, the improved economic outlook led to a sharp change in expectations in regard to renewed inflationary pressures and a turnabout in the trend of interest rates. A much larger Federal deficit loomed up than had been estimated, as well as the crisis and threat of military action in the Middle East. Concern about the drain of gold from the Nation's monetary reserves through sales of gold to the industrial nations of Europe was a further cause for uncertainty. The fact that the Canadian Government announced a major refunding operation at sharply higher interest rates was also a complicating factor.

In these circumstances, heavy market sales by holders of U.S. Government securities in anticipation of higher interest rates sharply depressed bond prices. Initially, this selling stemmed from temporary holders who had bought in anticipation of a continued rise in Government security prices. Some of these holdings had been acquired with funds borrowed on thin margins in connection with the Treasury's June financing operations. In many cases, selling was forced because the margins vanished as security prices declined.

The CHAIRMAN. Mr. Martin, may I ask you what were the required margins on these bond purchases?

Mr. MARTIN. Well, they varied. In general, 5 percent was around the maximum.

The CHAIRMAN. And what were the other margins?

Mr. MARTIN. Some went as low at 2 percent—perhaps lower in some cases.

The CHAIRMAN. On what type of Government obligations did you have the 2-percent margin?

Mr. MARTIN. On the short terms.

The CHAIRMAN. How long?

Mr. MARTIN. Well, usually up to 5 years.

The CHAIRMAN. Up to 5 years?

Mr. MARTIN. Right.

The CHAIRMAN. This was the chief form of Government note issued in June, was it not?

Mr. MARTIN. Well, it was a little longer than that. The 2⅝'s was 6 years and 7 months.

The CHAIRMAN. And was it a 5-percent margin on that?

Mr. MARTIN. Most of those probably ran from 2 to 5 percent because there is no specific regulation—there could be further variation in either direction. It is handled by the individual house.

The CHAIRMAN. Does the Reserve fix the margin on the Government bonds?

Mr. MARTIN. No; not on Government bonds.

The CHAIRMAN. You fix the margin on stocks; don't you?

Mr. MARTIN. That is correct.

The CHAIRMAN. Do you have the legal power to fix the margin on bonds?

Mr. MARTIN. We do not.

The CHAIRMAN. Are you sure of that?

Mr. MARTIN. Yes.

Government bonds are specifically exempted in the margin regulations, Senator.

The CHAIRMAN. You mean in margin legislation.

Mr. MARTIN. At the time the legislation was adopted. I remember it very well when it came up.

The CHAIRMAN. You haven't asked for powers; have you?

Mr. MARTIN. No; we have not asked for powers.

The CHAIRMAN. Are you contemplating asking for powers?

Mr. MARTIN. We are making a study of that right now.

The CHAIRMAN. A study in the Federal Reserve is apt to go on for a considerable period of time. Do you expect to complete your study this year?

Mr. MARTIN. I make no promises on these studies. But, I think we have completed a number of our studies fairly promptly, Senator.

The CHAIRMAN. Thank you.

Mr. MARTIN. Prices of Government securities continued to decline under pressure of steady liquidation and the reluctance of investors to purchase market offerings in view of changed prospects for credit demands and inflationary threats. On July 18, the Federal Open Market Committee concluded that the market situation had become disorderly and decided to intervene temporarily in the medium- and long-term sectors of the Government securities market. This action was within the framework of the Committee's established operating rules. From July 18 to July 23 the System purchased $1.2 billion of securities involved in a Treasury refinancing and a small amount of other notes and bonds.

Thereafter, as market conditions became more orderly, no further Federal Reserve open-market transactions were effected outside the usual area of short-term Government securities. During late July and early August, sales of Treasury bills by the System together with other factors that absorb reserves more than offset the large volume of reserves supplied to the market by Federal Reserve intervention in the Government bond market.

### SHIFT IN FEDERAL RESERVE POLICY

By this time, there was clear evidence in current statistics that recovery in economic activity and production, though not yet in employment, had gained considerable momentum and was likely to go forward without serious setback. Moreover, in view of the strength of consumer demand, further decline in business inventory holdings and capital outlays was no longer likely. Monetary policy was now reinforcing the existing foundation of productive activity and was preparing the economy for a new advance.

About this time, inflationary expectations began to spread. The abrupt upward shift of interest levels in central money markets, while precipitated by liquidation of speculative positions in Government securities, reflected investor demand for an interest premium to cover the risk of a depreciating purchasing power of invested funds. It was accompanied by a significant shift in investor allocation of newly available funds to common stocks instead of fixed interest obligations, with hedging against inflation a frequent explanation of the change in investor policy. Large current and prospective demands for credit by the Federal Government, State, and local governments, and home purchasers, also influenced the rising cost of borrowed funds. In the stock market, the volume of trading was expanding rapidly and the rise in stock prices carried the yields on common stocks below the yields on bonds of the same companies.

Developments in our financial markets, as well as the very large deficit which the Federal Government was facing, were occasioning concern, abroad as well as at home, about the future of the dollar. The extent of concern among foreign financial leaders was clearly evident last fall at the annual meeting of the International Bank and Monetary Fund at New Delhi, India.

In the light of the rapidly changing economic situation, in many ways highly encouraging but with inflationary and speculative psychology spreading, the Federal Reserve, during the summer, began to moderate the policy of credit ease with a view to tempering the rate of bank credit and monetary expansion.

System open market operations after midsummer supplied only a portion of the reserves needed to meet rising credit demands and to offset the reserve drain of a continued gold outflow. As a result, member banks were obliged to draw down their excess reserves and to increase their borrowings from the Federal Reserve bank. Such borrowing was made more costly when Reserve bank discount rates were raised in the late summer from 1¾ percent to 2 percent, and at midfall when they were again raised to a level of 2½ percent.

Since last summer, bank credits and the money supply have continued to expand but at a rate much reduced from earlier in the year. Some seasonal expansion in business loans was supplemented by a rapid growth of real estate loans. On the other hand, bank holdings of short-term U.S. Government securities rose only moderately despite a substantial increase in their supply to finance the Treasury's deficit. With business sales and liquidity showing rapid rise, the higher interest rates that developed in the market helped to attract a substantial volume of funds of nonbank investors, especially business corporations, into the purchase of the new short-term Treasury issues. As a consequence, the Treasury was able to finance most of its deficit outside the banking system, and at the same time banks were able to meet private credit demands accompanying economic recovery, with only a moderate further growth in total bank credit and money.

### REGULATION OF MARGIN REQUIREMENTS

In addition to its broader monetary responsibilities, the Federal Reserve is directed by law to prescribe margin requirements to guard against excessive use of credit for purchasing or carrying stock market securities. By providing a means of dealing directly with this volatile type of credit, margin requirements serve as a special-purpose supplement to the general instruments of Federal Reserve action. Since the flow of credit into the stock market fluctuates with general business conditions, changes in margin requirements are usually correlated with policy actions that affect general credit availability.

Following the stock market decline in the early fall of 1957, total credit to customers for purchasing and carrying stock market securities declined by about 5 percent and was back to about the level outstanding in mid-1955. With this indication of abatement of credit use in the stock market, the Board of Governors, early in January 1958, reduced the margin from 70 to 50 percent.

With the increasing activity and rise in stock prices accompanying economic recovery, stock market credit rose sharply, reaching by July a level about 20 percent above the volume at the beginning of the year. In view of the rapid rise in credit to finance trading in or temporary ownership of stocks and the emerging investment psychology favoring purchase of stocks as an inflation hedge, the Board, early last August, restored the required margin to 70 percent. As outstanding stock market credit continued to rise following this action, the Board, in mid-October, raised the required margin to 90 percent.

### THE CURRENT SITUATION

The shift in monetary policy during the fall alined monetary expansion more closely with the developing potential of the economy. Consumer spending on durable goods and housing continued to expand and was reflected in high levels of output of household durables, in a pickup in production of 1959 autos, and in a rise in new housing starts to one of the highest levels in recent years. Business inventory policies were switching from liquidation toward accumulation, and there was a widespread, though small, upturn in capital expenditures. At the same time, Federal, as well as State and local government spending, was expanding rapidly in accordance with budgetary authorizations adopted earlier.

In financial markets moderate curtailment of credit availability and higher interest rates served to dampen speculative excesses then developing, to restrain and spread out the volume of new corporate and municipal security financing, and to facilitate the financing of the large Federal deficit outside the banking system. The restraint of corporate and municipal security financing followed some anticipatory borrowing by these issuers earlier in the year when long-term interest rates were lower. At the turn of the year, business capital financing was again rising, and there was a large calendar of authorized but unissued State and local government securities.

Total economic activity, measured in real terms, has regained its earlier peak. The active money supply has increased by about 2½ percent above the prerecession level, and holdings of other liquid assets, including time deposits, are up sharply. The financial basis for further growth is established. While economic prospects are generally favorable, there are several areas—unemployment, exports, prices, and Federal finance—that are matters for continuing concern.

Despite the rapid recovery in production and sales, unemployment remains disquietingly high. The lag in employment is in part the result of a marked increase in productivity. The present availability of capital and manpower resources represents a potential for near-term growth of the economy without inflation. As output of goods and services expands in response to growing demands, opportunities for employment should increase as they have in past periods of economic expansion.

In exports, which declined sharply until early last year, recovery has not yet set in. The export decline was largely in materials and fuels and was due in part to the ending of boom conditions abroad; resumption of economic expansion is now beginning in industrial countries abroad and eventually there should be some improvement in foreign demand for our exports. It is significant, however, that the European countries which announced a broader convertibility for their currencies at the end of 1958—and other countries, too—are giving our exports of manufacturers still competition in price and quality, and these countries are now able to devote a larger share of their resources to their own exports than they could in earlier postwar years. While this reflects progress toward international balance, our producers need to adjust to these competitive forces abroad if they are to share in growing world markets.

Prospects for our international payments position thus merge with the third problem; that is, our price system. A market economy such as ours depends upon the price mechanism to allocate resources by reflecting the interplay of demand and supply. The price mechanism cannot do its job of efficient resource allocation in accordance with the changing demands of consumers unless there is some flexibility in individual prices. This does not mean that wide swings in the general price level are desirable. The price paid by Smith represents the income of Jones. But there is cause for concern when, in spite of a decline in the demand for his product, Jones raises his price, and an opportunity to stimulate both output and employment is thwarted. This is particularly disturbing when it comes on top of a price rise that Jones made when the demand for his product increased. Such a one-way movement of prices—whether it is explained as demand pull, cost push, or both—is not compatible with an efficient market system. If it were to be continued indefinitely, it would pose a serious threat to the otherwise favorable prospects for healthy growth in consumption and production.

Now as to Federal finances, it is essential at this stage of the economic cycle that the Government should attain a balanced budget and then achieve some surplus as economic advance continues. Whatever the desirable level of expenditures, deficits, while they may be justified in time of recession, should be avoided when economy is at a high level of activity.

It is also of vital importance to have a healthy, broad-based Government securities market that enables the Treasury to lodge its debt outside the banking system. In other words, the Treasury must be able to compete effectively and flexibly with other borrowers for the available supply of savings.

Appropriate debt management policies, while contributing to financial stability, are in turn dependent on such stability. Investors cannot be induced to purchase fixed-income securities if they fear a steady erosion of the purchasing power of the dollar.

The banking system has an important role to play in aiding the Treasury's financing. This role involves assistance in the broad distribution of securities and, in accordance with the volume of reserves made available and the meeting of essential private credit demands, the retention by banks of that portion of the Government debt that is consistent with stability of the dollar. Resort to financing Government deficits through the banking system entails the creation of new supplies of money rather than the use of existing funds. In a period of high economic activity, this is a high road to monetary inflation. There can be no effective control of inflation if the banking system is made the major source of funds to finance Government deficits.

## GOVERNMENT POLICIES AND ECONOMIC GROWTH

As the U.S. economy emerges from the recession of 1957–58, it seems likely, if past experience is a guide, that we are on the threshold of a new period of economic growth. This is an opportune occasion, therefore, to consider the question of appropriate public and private policies to foster steady expansion of the economy.

Economic growth is a principal objective of governmental policy in every country of the world. The rate of growth is widely accepted as an indicator of the performance of an economy. A word of caution is in order, however, regarding the very difficult task of measuring growth. Growth measurements, particularly when they cover long periods of time and comparisons of one country with another, are necessarily approximations. They vary with a host of factors, including the scope of activities covered, both public and private; the character of such activities; quality as contrasted to quantity of output; and many others. Nevertheless, regardless of these measurement difficulties, growth estimates, properly constructed and interpreted, can be useful aids in appraising economic performance.

Desirable economic growth goes beyond increases in line with a growing population and labor force. It involves a rate that makes possible rising living standards through increasing consumption per capital for present and future generations. This requires increasing output per worker; that is, higher productivity through advancing technology.

In our economy, consumption takes the form mainly of consumer purchases of the goods and services supplied in free markets by private producers and merchants. Our living standards also encompass services provided by the various levels of government. Fundamentally, economic growth at a more rapid rate than population increase is the response of men to their ever-increasing wants.

Among the other reasons for seeking economic growth is the importance of demonstrating to the world that free economies under democratic political systems can outperform regimented economies under dictatorial political systems in providing high and rising living standards for all of the people.

Economic progress, however, cannot be measured merely by percentage increases in the quantity of output. Also at stake is the opportunity to live as freemen, the responsiveness of the productive system to the desires and tastes of consumers, the quality of goods and services, the degree of leisure and opportunities for using it in a satisfying way, and our willingness to aid other nations seeking similar advantages. These aspects of our economic performance will have a great influence on how the rest of the world judges the merits of free versus regimented economies.

## ECONOMIC GROWTH WITHOUT INFLATION

When we consider the influence of governmental policies on economic growth, it is useful to distinguish between two related aspects of the process. First, growth involves expanding capacity to produce goods and services. Second, it involves expanding demands for goods and services at a rate sufficient to utilize the expanded capacity.

The first aspect of growth—an expanding output potential—depends upon such basic factors as additions to the labor force, advancing technology, and a flow of savings combined with a desire and ability on the part of producers to use them in the creation of a growing stock of modern plant and equipment. The other aspect of growth depends upon a balanced expansion in demands for final product by the major sectors of the economy—that is, households, businesses, governments at the State and local as well as the Federal level, and demands from abroad.

For growth to be sustainable, an equilibrium between these two sides of growth must be maintained. If total demands do not keep up with the output potential, overall growth will slacken, for the inducement to business to add to productive capacity will lessen. If total demands tend to run ahead of the output potential, the general price level will begin to rise and this, in turn, will have an adverse impact both on growth of demands and on means of financing increased and improved capacity. It will also have adverse effects on the efficiency with which resources are utilized; likewise, the equity or fairness with which final products are distributed in markets among consumers, businesses, and savers.

What, then, is the function of monetary policy in relation to these two aspects of growth? In general, it is to attempt to provide credit and monetary resources and an atmosphere in financial markets conducive to the basic growth factors. At the same time, aggregate demand for goods and services should expand in close relation to the capacity to produce.

On the demand side, growth basically depends on spending out of incomes earned in the production of goods and supplying of services. Monetary policy facilitates the expansion of money holdings, through sound credit expansion, consistent with the growing capacity of the economy to produce without inflation.

On the supply side, basic growth factors are the labor force, technology, and investment of savings. Growth of the labor force is to some extent influenced by overall demands, but more generally by population growth, age distribution, and social customs. Technological progress and the desire to save and invest savings productively are influenced by the monetary environment. An atmosphere of price and financial stability in general is necessary both to the incentive to save and to rapid technological advance. Thus, through continuous efforts to safeguard the value of the dollar and to create a climate of financial stability in which savers can have confidence in the future value of their investments, monetary policy makes a contribution to economic growth quite apart from its influence on demands for goods and services.

It is for these reasons that price and financial stability are essential to the achievement of maximum economic growth. We have had a fairly good growth record over our history, but we have had too much instability in our levels of employment and prices. A major problem is to moderate this instability so that the losses in employment and output of recession periods will not depress our longer term rate of growth. Currently there is widespread concern about the danger of renewal of inflationary trends. The Federal Reserve shares that concern. To point to dangers in this situation is not to forecast inflation. Public and private actions appropriate to present circumstances can prevent these dangers from materializing.

Among potential inflationary factors first, and perhaps foremost, is the budgetary position of the Federal Government. As the economy moves up toward more intensive utilization of its productive resources, it is essential that deficits give way to surpluses. There is no mystery about this source of danger. If the will exists, the way will be found to correct this. It clearly lies in the adaptation of Federal expenditure and tax policies in order to produce a budgetary surplus in prosperous times.

Second, there are the problems arising from the so-called cost-push inflation which is part of a spiral process stimulated by demand pressures. In the period ahead there is a strong prospect that demands will continue to expand. In these circumstances, we must recognize the dangers both of wage increases in excess of productivity growth and of price increases beyond what the traffic will bear. Business and labor leaders have a paramount responsibility to the general public as they make wage and price decisions over the coming year.

Then there is the easy acceptance of the idea that a little inflation is not seriously harmful. The experience in the Government bond market, to which I alluded, is a vivid example of the influence of inflationary expectations in financial markets. To the extend that such attitudes come to be reflected in decisions on wages, prices, consumption, and investment, they help to bring about their own realization.

These are the major reasons for concern about the possible development of inflationary pressures. To be fully aware of a danger, and to face up to it, is not to despair or to capitulate, nor does it mean being blind to other national needs, including sustained economic growth.

The Federal Reserve System will continue to the best of its ability to contribute, so far as it can, to continuing prosperity and economic growth, without inflation. Such decisions as it must make within its particular province manifestly are not enough to assure attainment of the national objectives to which we all subscribe. What this Congress decides, what management, labor, agriculture and, indeed, the public generally decide to do will win or lose the battle against debasement of the currency with all of its perils to free institutions.

The state of the Nation tomorrow—its progress and prosperity—rests with the decisions of today.

The CHAIRMAN. Thank you, Mr. Martin.

Now, you are, of course, familiar with the section 8 of article I of the Constitution which lays down the specifically delegated powers of Congress, which, in the first paragraph states that "Congress shall have power," and so forth, to "coin money," and "regulate the value thereof."

Does this, in your judgment, give to Congress the ultimate power to regulate the total money supply of the country?

Mr. MARTIN. Well, it says the value insofar as that relates to the total money supply.

The CHAIRMAN. Insofar as the quantity of money affects the price level, therefore the value of each unit of the currency, you say Congress has the power to regulate the total money supply?

Mr. MARTIN. That is right. Congress can also debase the currency.

The CHAIRMAN. But it has the power to protect the currency too, doesn't it?

Mr. MARTIN. Yes; but I am trying to point out that it works both ways.

The CHAIRMAN. Has Congress delegated some of these powers to you?

Mr. MARTIN. Congress, in the Federal Reserve Act, has handed to us a trusteeship over money.

The CHAIRMAN. You act as agents of Congress.

Mr. MARTIN. As agents of the Congress; yes.

The CHAIRMAN. And not as agents of the Executive.

Mr. MARTIN. Not as agents of the Executive, but under the trust indenture given us by the Congress.

The CHAIRMAN. And if Congress passes any act or resolution, you would regard it as binding upon you?

Mr. MARTIN. Most certainly.

The CHAIRMAN. Do you also operate under the terms of the so-called Full Employment Act?

Mr. MARTIN. We do.

The CHAIRMAN. Which states that Congress declares that it is a continuing policy of the Federal Government to promote maximum employment, production, and purchasing power.

Mr. MARTIN. Yes.

The CHAIRMAN. Mr. Martin, you have been discussing the dangers of inflation, and I think we are all aware of the evils of inflation, but

I would like to ask you this: Has there been any inflation of the price level during the past 9 months, or year?

Mr. MARTIN. The price level has been steady for the last 6 months, and the immediate outlook is favorable to a continuation.

The CHAIRMAN. You don't anticipate any increase in the price level during 1959?

Mr. MARTIN. No; I think that there is a real possibility of serious increase in the price level of 1959.

The CHAIRMAN. Toward the latter part of the year?

Mr. MARTIN. I won't specify when, but during the year.

The CHAIRMAN. Well, testimony that we have had from other economists is that they expect a substantial stability of the general price level, but a fall of the agriculture prices during 1959. However long in the immediate future that may be, you do not anticipate any increase in prices in the immediate future?

Mr. MARTIN. I wouldn't go that far. I would say that the flammable material is lying around for an increase in prices.

The CHAIRMAN. Well, I misunderstood you. I thought you said that there had been no increase in prices in the last 6 months and one should extend that to 9 or 10 months because the index of wholesale prices in March of 1958 was 119.7 and in December, 119.2.

This is now the first of February, and we have had almost a year of stable prices, and I understood you to say that you do not expect any immediate increase in prices.

Mr. MARTIN. Well, I'm talking about the next 30 days.

The CHAIRMAN. Well, what about the next 60 days?

Mr. MARTIN. Now you are pinpointing the time issue. I say that at any time you could have a breakout of price increases as a result of the inflammable material that I see lying around.

The CHAIRMAN. You say that the danger is not only clear, but present.

Mr. MARTIN. Yes; I think it is present, Senator.

The CHAIRMAN. Well, I may say this: What you say is contrary to the testimony which we have had from other economists.

Mr. MARTIN. That is a matter of judgment. I simply state my own conviction on it and my own judgment on it.

The CHAIRMAN. Did you think there was danger of inflation in August of 1957?

Mr. MARTIN. In August of 1957 inflation had already gotten ahead of us, as I have previously testified, to the extent that a recession was, in my judgment, inevitable.

The CHAIRMAN. On August 9 you increased the discount rate from 3 to 3½, and this was made permanent across the board for all the banks on the 23d of August. It was just at that time that the American economy began to decline; isn't that true?

Mr. MARTIN. As you state in one of your questions here—in hindsight, you can always pinpoint when the economy begins to decline.

The CHAIRMAN. You see, this is one of the things that we should impose on forecasters.

Forecasters tend to escape from their past. They forceast what is going to happen, but then I think we should always ask how reliable their forecast has been; to what degree in the past has it been accurate?

I certainly want to point out, and not with malice at all, but in the case of August of 1957 you mistook the turning point and you thought there was inflation, and full employment. Instead of that, you took this action at the precise time that the economy began to nosedive.

I am not reflecting on your character in the slightest, Mr. Martin, but if you come forward with a forecast, I think it is proper to point out what happened to your previous forecasts.

Mr. MARTIN. I would like to make my usual statement on that, Senator.

I think inflation is a process, not a condition.

The CHAIRMAN. And it was starting in August of 1957?

Mr. MARTIN. No; the problem was that it built up in 1956 and 1957.

What we are trying to do now is fight the next recession. The effective time to fight a recession is in the period of the preceding buildup.

Now, in 1957, in the early part, we were losing $1 billion per month in gross national product without any additional goods and services being produced.

That is the condition from which a reaction would eventually take place, in my judgment, and in the anticipation of which we unquestionably were right.

Now, monetary policy was not the entire factor in it, but I do not believe that monetary policy was responsible for the 1957 period.

You will recall that I have admitted error on occasion.

The CHAIRMAN. I have never heard you do so, but I will be very glad to hear it now.

Mr. MARTIN. All right, I have. But, I will say in this instance I do not admit error.

The CHAIRMAN. Now, you say that the time to check the next recession is in the period of buildup.

You would not say the time to check the next recession is when you are in the previous recession, would you?

Mr. MARTIN. Well, I think it is both.

The CHAIRMAN. The time to check the recession is when you are in the existing recession, is that what you are saying?

Mr. MARTIN. We are in a recovery now.

The CHAIRMAN. We are not in a recession now?

Mr. MARTIN. No.

The CHAIRMAN. Are we at full production?

Mr. MARTIN. No.

The CHAIRMAN. We have at least 6 percent fully unemployed, do we not?

Mr. MARTIN. We have about 6 percent unemployed.

The CHAIRMAN. Plus the equivalent of another million partially unemployed, that is those on involuntarily part time, making a total ratio of 7 percent.

We have, according to either your figures or the Department of Commerce figures, 24 percent idle capacity in the factories. You are worried, you say, about the immediate dangers of inflation. But, prices have been stable for almost a year.

Mr. MARTIN. I want to get these unemployed back to work. I happen to believe that the adjustments in market will do a better job of getting them back to work than in any other way.

I believe that some employment will be provided by further adjustments in the market.

The CHAIRMAN. Suppose you find, after 6 months, that they are not back at work. What do you do then, and if the ratio is about the same as now, what would you do?

Mr. MARTIN. Well, I can't say. I have a little paper here on economic advance and high unemployment which I would be glad to put in the record.

The CHAIRMAN. We will be glad to have it.

(The matter referred to is as follows:)

### ECONOMIC ADVANCE AND HIGH UNEMPLOYMENT[1]

Employment gains have lagged output gains in this recovery, as they usually do. The lag, however, has been greater than in preceding postwar recovery periods, and the level attained by unemployment has been both higher and somewhat more sluggish in its response to rising activity. Thus, while real GNP and industrial production are currently both within striking distance of earlier highs, nonfarm employment—up 700,000 from its recession low—has regained less than a third of its recession loss of 2.4 million jobs.

Since September, there has been little evidence of any extensive general rehiring of workers other than for seasonal reasons. In the two preceding postwar recession-recoveries, employment stabilized for a number of months after the recession bottom, but once recovery set in, employment increases were not halted until a new peak was reached.

What accounts for the slower pickup in employment in this cycle than in preceding postwar cycles? Several factors may be mentioned.

(1) Productivity increases in manufacturing industry have apparently been higher this time than in the earlier recovery periods, reflecting very high modernization investment in preceding boom as well as the greatly expanded industrial research and development programs of the boom period. For instance, automobile output in December, while only 4 percent lower than in December 1956, provided one-fifth less in production worker employment than 2 years earlier. The railroads, while carrying about as much freight as in late 1957, provided 10 percent less employment. Similarly, the coal mines have been about equaling output levels of a year ago with about 15 percent fewer employees.

The larger productivity gains of this recovery period may also be a factor in recent stabilizing of average hours of work per week in all manufacturing industry. Virtually all of the recession decline in hours worked had been recovered by last September and there has been no further gain since. In earlier postwar cycles, hours of work continued to increase long after this stage of recovery. It is important here to note that, since 1955, there seems to have been a downward drift in the length of the workweek.

(2) It may well be that labor cost increases of recent years have made management more cost conscious than in any earlier period and that greater efforts are now being applied to limiting employment and overtime increases in order to keep costs down. Also, postwar growth in fringe benefits now makes recordkeeping costs and benefit liabilities rise rapidly as new workers are hired, and this would operate to slow down management decisions to add to work forces.

(3) In machinery and other industries associated with investment outlays, employment has shown little recovery rise because expansion in fixed investment has not yet shown marked revival. In the past, expansion of nonproduction worker employment, associated especially with research and development, has been correlated with rising investment. In the preceding two cycles, business investment had shown much more revival than has been shown up to the present point in this cycle.

(4) Nonmanufacturing employment, which had shown strong growth through the whole postwar period, with only modest slackening of expansion in the two preceding downturns, declined moderately in this recent recession and has shown little expansive tendency in recovery. Judging by the rise in nonindustrial GNP

[1] A Federal Reserve Board staff paper presented for the record of the Joint Economic Committee by Chairman Martin at a hearing Feb. 6, 1959.

since last spring, perhaps as sharp or sharper productivity gains have been experienced in nonmanufacturing activities as in manufacturing industries during this recovery period. Presumably these nonmanufacturing activities are digesting earlier postwar increases in the working force.

(5) The industries in which recession declines in employment have been highest and greater than in preceding recessions have been durable manufacturing, railroads, and mining. These industries have been subject to a secular decline in postwar years in employment of semiskilled workers, with reductions in semiskilled jobs more accentuated in each succeeding recession-recovery period. This means, of course, a sizable problem of transfer of employment to other gainful activities, a problem that can be only resolved slowly.

With the rise in employment opportunities lagging, that is to say, showing slower advance than in preceding postwar recoveries, what about the unemployment problem and prospects over the months ahead?

Unemployment has been higher all through this recession-recovery period than in earlier postwar cycles. It reached a seasonally adjusted high of 7.5 percent of the labor force in the summer and declined to about 6 percent subsequently. In numbers of unemployed, the decline has been about 1 million workers.

While unemployment has been higher than in preceding cyclical dips, the general pattern of rise and decline has not been dissimilar to that of preceding cycles. The seasonally adjusted unemployment did not fall below 4.5 percent of the labor force in the 1949–50 recovery until about 12 months after recession ebb, and in the 1953–54 recovery this rate was not pierced until after 10 months. In the Korean boom, the unemployment rate fell to under 3 percent, but in the 1955–57 boom, 4 percent constituted a floor and most of the time the rate fluctuated just above 4 percent.

In the two earlier postwar recoveries, employment rose and unemployment declined at the same time that sizable additions were being made to the working force. In the recent recession, part of the rise in unemployment was due to the large number of secondary earners who entered the working force when primary earners had their pay reduced or lost their jobs. The recent decline in unemployment has reflected in part withdrawal from the work force of many of these secondary earners as well as withdrawal of some older and younger workers for want of job opportunities.

Recovery in job opportunities has been uneven for different groups of workers. Younger workers have generally fared better than older workers, and females better than males. Relatively high rates of unemployment persist for durable goods workers, semiskilled and unskilled workers, and for nonwhite workers. Among those with long duration unemployment, durable goods workers, miners, and railroad workers are numerous in relation to their role in the labor force.

Recovery reemployment has also been uneven geographically. In California, employment has returned to prerecession highs. In Michigan, it has fluctuated only seasonally and unemployment is currently well above last year's rates. At midsummer, the number of substantial surplus labor markets was 89 out of 149, and by the present month the number of such markets had declined by only 13. The concentration of substantial surplus markets continues to be in the East and Midwest.

Two observations about current labor market conditions seem warranted from this review. First, on the supply side, a conjuncture of secular and cylical forces seems to have contributed to the present volume and composition of unemployment. As we have noted, a high proportion of the unemployed is concentrated in durable goods and related industries, making the continuing unemployment problem a cluster of localized problems rather than a general problem. But this may also work to make unemployment slack linger on. The terms "technological unemployment" and "labor immobility" undoubtedly will be used more frequently again to describe a possibly slower decline in the unemployment rate than featured the earlier cycles. However, given appropriate job opportunities, the American worker has been extremely mobile in adopting to new occupations and new conditions.

Second, on the demand side, the labor market in the recent period has, on the whole, been experiencing a less vigorous demand for labor than in the comparable phase of the other postwar cycles. But as consumption expenditures rise further and as capital expenditures begin actively to expand, demand for labor will surely strengthen, and particularly in the durable goods areas where unemployment is now concentrated. Gains in worker productivity are typically high in the recovery phase of the cycle and then slow down in the expansion phase. Gains in output in the expansion phase increasingly require utilization of older facilities and these facilities take more manpower per unit of output.

How fast available manpower resources will be taken up in the period ahead depends on the pace of further expansion in aggregate demand and especially of durable goods demand and on the strength of competitive responses, especially price response, in meeting additional growth in demand. If expansion in money demand is dissipated in price advance, the employment impact will, of course, be lessened.

Taking into account the relatively larger pool of unemployed manpower at this stage of the present cycle compared with earlier postwar cycles, it seems reasonable to observe that manpower availability will not become a limiting factor on the further increase in total production nearly so soon as it did in the two preceding cycles.

If inflationary tendencies can be checked, currently available manpower resources and unused capacity can provide the basis for an extended period of economic growth.

Mr. MARTIN. Because we have done a lot of working and thinking on it.

We think you have technological unemployment problems and labor immobility problems, and we all agree there will be some unemployment and that we ought to do everything we can to ameliorate that.

The CHAIRMAN. But, you're not able to state whether you regard the continuance of 6 percent unemployed as serious?

Mr. MARTIN. I won't make a statement on any level of unemployment because I always consider it serious.

The CHAIRMAN. You will not say that the continuation of the present level of unemployment with idle resources is serious?

Mr. MARTIN. I would say that it is serious, but the most effective way to get back to working is to have stability in prices.

The CHAIRMAN. To you the all-important matter is the stability in prices. That is important to us too, but growth is also important to us and comparatively full employment is also important to us.

These issues are more than personal, Mr. Martin. They are very fundamental. Bankers always tend to look at one set of facts, namely, price stability.

Mr. MARTIN. There is nothing personal in any of my remarks, Senator. You and I are seeking the same end. We just have different means of attaining it, perhaps.

I think that the growth that you are talking about comes about through stability.

Stability is not an end in itself—it is a means to a better standard of living, and I believe we would have had much more growth over the last 10 years and much more permanent growth, if there had been more stability in the economy and there had not been this recurrent instability in both employment and prices. I believe the two work together.

The CHAIRMAN. Now, Mr. Martin, one other point. I say this in all kindness.

Four years ago, Senator Fulbright initiated an investigation into stock market prices. He was inquiring as to whether they might not have risen too rapidly.

The then Secretary of Treasury issued a statement, publicly and to the press, criticizing this investigation on the grounds that by discussing these matters it might shake confidence in the stock market and depress the price of stocks.

I think you were much more gentlemanly in your conduct and I can't remember what you said, but that is neither here nor there.

During the summer and fall, as this talk of inflation has mounted, the prices of Government bonds continued to drop, and you speak of the inflation psychology which has spread, and I think it has spread. It is largely unsupported by facts, and emphasizes a danger, which is, in part, fictitious.

Does it not result in undue falling in the price of Government bonds and hence a rise in the interest rate?

Mr. MARTIN. Well, Senator, prices tend to move too much in both directions whenever trends develop, whether it is in the securities market or in any other market. But the savings-investment process, which is at stake here, is, in my judgment, the primary food for the growth of an enterprise economy, and when it is at any time impaired, then you have a problem to be concerned with.

We have that problem today.

The CHAIRMAN. My time is up, but I want to ask you one more question.

If people are led to believe that inflation is coming, even though it is not coming, they will pay less for Government bonds and they will shift from bonds into stocks, isn't that true? Prices of Government bonds will fall; prices of stocks will rise, the yield on Government bonds will rise, the interest rate rises. Isn't that so?

Mr. MARTIN. That is correct.

The CHAIRMAN. Now, isn't it important therefore, that just as private industry should be cautious in their comments about stock market prices, so Government officials should be cautious about talk concerning inflation because even with the best of motives, and let me say that I think you have the best of motives and I am ready to credit the Secretary of the Treasury with the best of motives, but, even with the best of motives this talk of inflation inevitability drives down the price of Government bonds and makes the problem of financing for the Government more difficult.

Mr. MARTIN. I am glad you raised that, Senator, because I want to give you my thinking on it.

I think we should be very careful about the statements we make, and I think one of the problems, in my job at least, is that you should never take yourself too seriously. I think likewise that you cannot take yourself seriously enough, and if, in your judgment, after consideration of all the factors, the thing is one that warrants discussion, and let me say it is not for me to decide whether the judgment is correct or incorrect, but after having weighed it very carefully and decided that it warrants discussion, then I think you can't just say that this is something that will go away—or that I will sweep it under the table and hope it won't come out.

I considered that exeremely carefully over the last 3 months.

The CHAIRMAN. I say that my remarks were not addressed to you as much as they are addressed to the political figures over your shoulder, so to speak. That is all I have.

Mr. Kilburn, did you have some questions?

Representative KILBURN. Thank you, Mr. Chairman. Mr. Martin, some members of this committee went to Europe last year and I was one of them.

I would like to tell you that I had a visit with several of the heads of banks in some of those countries who correspond to the position you hold in the Federal Reserve here, and everyone of those people told me that they thought you were doing an outstanding job for our country in your capacity in the Federal Reserve. I wanted to tell you that.

Mr. MARTIN. Thank you, sir.

Representative KILBURN. In yesterday's hearing, my friend, Mr. Patman, made a statement which I would like to have you discuss.

He said:

> I want to disagree with my good friend Mr. Kilburn of New York in his statement that market money rates are fixed by law of supply and demand. My personal opinion is that the Federal Reserve fixes the money rates. It is done deliberately. It is done over a period of years, for 13 years or longer where they have held the long-term bond rate at 2½ percent. The Chairman of the Federal Reserve Board has testified before different committees and answered the question that they can fix the money rate at any rate they want to and hold it there. They can fix it at 2 percent, 3 percent, 4 percent and hold the rate where they fix it.

Representative PATMAN. Read on, please.

Representative KILBURN. (Reading):

> I think you would have to agree with all the monetary weapons they have at their command, open market operations and discount rates, that they are probably right. They could fix the rate at any rate they wanted to fix it, and hold it.

Would you like to comment on that?

Mr. MARTIN. Well, I would say that the reference must refer to one of my predecessors. I have never so testified, but I would say that in the wartime period it was done, and I would say that if we had no regard for the purchasing power of money and want to take that form of printing money that we can unquestionably arrive at a rate and hold it for a long period of time.

I think it would be frustrated in the long run by the forces of the ebb and flow of supply and demand.

Representative KILBURN. If I understand you corerctly, you mean that the Federal Reserve would print notes and buy up Government bonds?

Mr. MARTIN. Exactly.

Representative PATMAN. Mr. Martin, there are ways to stop the inflationary forces too, that you are acquainted with.

You do not have to accept anything that is inflationary without applying some remedy to offset it, do you?

Mr. MARTIN. Are you referring to price and wage controls?

Representative PATMAN. I am talking about Government bonds. You know we have often discussed this. If you were to have the Federal Reserve take over all the short-term financing, for instance, instead of selling it in the open market and paying the interest, the people would save the interest if the securities were sold to the Federal Reserve. Would you say, Mr. Martin, that there are ways to prevent the inflation caused by that, and those remedies should be put out by the Federal Reserve?

You once said you could immobilize reserves. Do you remember saying that?

Mr. MARTIN. For a limited period of time, but you don't eliminate the reserves by immobilizing them.

Representative PATMAN. I will leave it there. I am disturbed over something that I consider fundamental, that the Federal Reserve has really seceded from the Government, I think in 1951, or at least it made an attempt to. I say that without impugning the motives of any member on the Board, and there is nothing personal in it. But, if there was an attempted secession, I think that was an attempted secession in which you declared you were no longer under any obligation to the Executive and I believe you state just now that the Executive has no power over the Federal Reserve Board. Is that correct?

Mr. MARTIN. Under the law, I think that is right.

Representative PATMAN. You think it is right. Now, the point I want you to clear up, Mr. Martin, is this. Our Constitution is a very fine document. We agree with that.

The first part written into our Constitution deals with the power of the legislative branch, which is close to the people; next, the executive, which is to enforce the laws that are made by the legislative branch, and then the judicial branch, to interpret, but not to make the laws.

The executive is what I want to call your attention to.

In article II of the Constitution it lays down certain things that the President must do in our form of Government.

The President shall do these things, and I will read just one of them:

> He shall take care that the laws be faithfully executed.

I believe you will have to admit that the Federal Reserve law is a law just like any other.

How do you get yourself out from under the Executive under this provision of the Constitution which imposes upon him, as a representative of the people, elected every 4 years, to take care that the laws, including the Federal Reserve Act, are faithfully executed?

Now, Mr. Martin, tell me how you get out from under that.

Mr. MARTIN. I wouldn't want to get out from under that. The independence we are talking about is independence within the Government, and not of the Government.

On the legal question of whether we are a part of the executive or not, that has never been put to a clear test, and it is a very, very complicated and difficult one.

I don't think it is of particular importance. I think the thing of importance is that we were given a trust indenture in the Federal Reserve Act.

Representative PATMAN. Reply to this, if you please. Let's talk about the Constitution. The Constitution says:

> The President shall take care that the laws be faithfully executed.

Do you say that does not apply to the Federal Reserve Act?

Mr. MARTIN. No, that applies to every act that the Congress passes.

Representative PATMAN. Well, you are under the President to that extent. If he observes that you are fixing interest rates against conscience, for instance, that you are charging the Government 4 percent interest for the use of its own credit, and you abuse the power, don't you think it is not only his prerogative, but his duty to step in and say, it is my duty, under the Constitution to take care that the laws be faithfully executed, and I declare that you are not faithfully executing this law and demand that you do something about it.

Don't you think he has the power to do it?

Mr. MARTIN. I should think he ought to go to the Congress with that.

Representative PATMAN. He is over the Congress in executing the law. He is the representative of the people. He is elected by the people every 4 years, and it has no duty to go to the Congress in executing the laws. The Constitution is the master of the President.

Now, don't you think it would be his duty, if there were misbehavior on the part of the Federal Reserve or where they were not faithfully executing the law, don't you think it is his duty to step in?

Mr. MARTIN. If he knew of malfeasance, or something of that sort, yes.

Representative PATMAN. I do want to get to the question that is very important here. You state that you made available about $2 billion of reserves last year. That would be the equivalent, under our price reserve system, of the banks creating about $12 billion in money, isn't that right?

Mr. MARTIN. If they use it.

Representative PATMAN. Isn't it a fact that they actually created $10 billion of that money and bought U.S. Government bonds with it, and that this credit expansion that you are talking about, the business expansion, was probably just a very small part of that; that the banks used the money which they created upon their own books without costing them 1 penny through your action of reducing their reserve requirements that they use that money to buy the Government's own bonds with it to the extent of about $10 billion as discosed by the Federal Reserve Bulletin of January 1959, page 33, which shows that on November 27, 1957, the banks owned $64,460 million in Government bonds. One year later, the latest figures we have, November 26, 1958, they owned $74,610 million.

In other words, that shows that the reserve requirements have been lowered so that the banks could issue more money on their reserves and therefore get the free use of $12 billion of additional money; that they used $10 billion of that in the purchase of the Government's own bonds. Is that not a correct statement?

Mr. MARTIN. Well, the periods of time are important for the answer to your question, Mr. Patman, because as we point out here they are at different periods than you cite from the bulletin.

You are correct when you say that the loans and investments of the member banks went up, and the principal reason they went up was purchase of Government securities during that period.

Now, we were actively pursuing an easy-money policy. We were doing everything in our power to adjust.

Representative PATMAN. That is right.

Mr. MARTIN. The decline in business, to stabilize it and make possible——

Representative PATMAN. And your statement sounds might good, that you were helping to finance this expansion, but were you really helping this business expansion? You were helping the banks out with $10 billion more, created money on their books, and only $2 billion went for busines expansion, if any went.

Mr. MARTIN. It is remarkable that the decline in business loans during the period was as small as it turned out to be. This was one of the factors in it, and once a decline is underway I think we should do everything in our power to be helpful.

Representative PATMAN. In speaking about groups of banks, I am not trying to pick out the New York banks because they are New York banks, but there are 18 banks listed here that at the end of November 1957, owned $5,423 million worth of Government obligations.

A year later, they had $7,694 million worth. In other words, they were, by your action, enabled to create more money on their books, free of charge, to purchase merely $2.5 billion more United States Government bonds last year.

Now, you did that by reducing their reserve requirements, and you did not at the same time reduce the reserve requirements of country banks.

I cannot understand why you discriminate against country banks.

You did reduce your reserve requirements on the 275 reserve city member banks, but just half as much as you did the New York and Chicago banks, and I cannot understand why that is not discrimination against the country banks.

Mr. MARTIN. Mr. Patman, as you know, trying to establish different reserve relationships is a problem, and we have a reserve bill——

Representative PATMAN. I know, Mr. Martin, now you have a reserve bill. Why do you not wait for that bill to pass? Why do you arbitrarily now, in administering the law, try to do what you claim Congress should do by law, and Congress has not done it?

Mr. MARTIN. Oh, no, there is no effort to do that.

Representative PATMAN. This shows it right here that you are discriminating against the country banks.

Mr. MARTIN. We had three reserve requirement adjustments.

In the case of the first two of them they were across the board.

Representative PATMAN. You reduced them in each one of them, but did not reduce the third.

Mr. MARTIN. In the first one, we reduced country banks also.

Representative PATMAN. Well, I have it here.

Mr. MARTIN. In the first and second instance we reduced every bank the same—across the board.

Representative PATMAN. Mr. Martin, you look on page 26 of your own bulletin, and you will find that for March 20, 1958, the country banks reserve requirements have remained the same, but you have reduced the reserve of city banks one-half of 1 percent, which was an enormous amount of money, in the New York banks, 2 percent.

How do you justify that when Congress has not passed that law that you have recommended to permit you to discriminate between banks or to equalize the bank reserves?

Mr. MARTIN. This was used as a monetary weapon, but let me call your attention to the fact that the first one, in February 1958, was from 20 to 19½ for central reserve of city banks; from 18 to 17½ for reserve of city banks; from 12 to 11½ for country banks.

Representative PATMAN. You are going back to 1953. Let us do that.

Mr. MARTIN. Oh, no.

Representative PATMAN. Well, let us go back to 1953. That is a good year, anyway.

Mr. MARTIN. The same thing applies in the action taken March 18, 1958, where it is 19½ to 19; 17½ to 17; 11½ to 11.

Representative PATMAN. I know, but since that time, Mr. Martin, you have not reduced country banks at all. Since that time you have reduced the reserve city banks, and since that time you have reduced the central reserves.

Mr. MARTIN. There was one final adjustment.

Representative PATMAN. Therefore, you are discriminating against the country banks to do what you say you would like to do under a bill which is pending in Congress, which Congress has not passed, and I know your goal is to equalize reserve requirements, and I think it is very unfair, and I do not think it will ever pass Congress. But you are trying to do this, it seems to me, before Congress passes the bill.

Mr. MARTIN. No, Mr. Patman; this was entirely a monetary responsibility that we were exercising there.

The country banks have at various times had much more in excess reserves than the others.

Representative PATMAN. They did not purchase the bonds, and they probably would not have under that very fine system of creating the money to do it.

The CHAIRMAN. Senator Bush?

Senator BUSH. Mr. Chairman, I think Mr. Martin has made a very excellent statement this morning, and I congratulate him on the forthright nature of his statements.

I would like to go into a couple of matters that Congressman Patman has raised here.

Yesterday, he raised a question, and he raised it very briefly this morning, but did not pursue it, the question of why wouldn't it be a good idea for all the deficit financing of the Government to be done directly through the Federal Reserve.

I am very much intrigued by that idea, because if we can finance a deficit that way, I should think that we could also finance maturities that way, and relieve us from any bother with the markets of the financial world.

In that way, we could very early reduce interest rates.

If we follow his suggestions to a logical conclusion, we ought to be able to go all the way—in other words, if we are going to finance the requirements of the deficit, then there is no reason, if that is sound, why it should not be pursued and finance maturities as they come due. Is that true?

Mr. MARTIN. That is right.

Senator BUSH. Will you explain to us for the record just what effect you think that would have, if we did carry his suggestion to the ultimate, logical conclusion of that?

Mr. MARTIN. Well, if you carried it to the ultimate conclusion, you would completely destroy the market for Government securities outside of the banking system and outside of the Federal Reserve.

A foreign central banker told me this summer that in his country they had tried something like that by applying a specialized reserve from time to time; that it had gotten to the point now where he didn't think it was possible for them to issue a security except to the central bank. They are now hoping to reverse that situation.

Senator BUSH. Well, this would, in effect, tend to monetize the whole debt, would it not, the Federal debt? On the Federal debt, of course, some of the returns are 20 or 30 years away, but the average maturity is less than 5 years and a very great bulk of it is very short. So if one followed that practice it would result in monetizing a high percentage of the total debt within a very few years, would it not?

Mr. MARTIN. That is right.

Senator BUSH. Which would have this effect: monetizing the debt would mean simply making money out of the debt or possibly interest-bearing money at a very low interest rate, if we follow the Congressman's suggestion, but it would tremendously increase the money supply within a very few years.

Mr. MARTIN. It would be as one of my predecessors stated, the best "engine of inflation" that you could possibly have.

Senator BUSH. That is the exact point I wanted to get on the record. With all respect to my good friend from Texas who devotes a great deal of his time studying the matter, I think that is one of the most dangerous suggestions that has ever been made before the Congress.

Now, Mr. Chairman, another thing about this constitutional question which Mr. Patman raised as to the President taking care that the law was faithfully executed, it seems to me—and I do not have the Federal Reserve Act here—but the way it has been described, it leaves the Federal Reserve in an independent position reporting to the Congress and not the Executive. That would seem to me to be the extent that it was the Executive's responsibility to see that the law was enforced. If he found the Federal Reserve was reporting to somebody else or in collusion with somebody else, then he might report that to the Congress in his state of the Union message, or otherwise in accordance with his constitutional duties.

But, it seems to me that the law tells him to keep his hands off and I believe he has kept his hands off since I have been down here, in connection with influencing the decisions of the Federal Reserve or otherwise interfering with its operations.

This comes up frequently on debates on money matters. It came up yesterday and the day before, and I have protested repeatedly that the administration itself has not attempted to influence interest rates. It has not attempted to influence interest rates.

It does not have a tight money policy. It does have a sound money policy, and to that extent I believe it has lent support to the Federal Reserve System.

Now, on the question that the distinguished chairman raises at these discussions on matters of inflation, I would like to go back to that for a moment and ask you, Mr. Martin, this question: If the dangerous conditions are there, and you say that there is a lot of flammable material lying around at the present time, is it not true that it doesn't make very much difference whether Government officials or Senators warn of these conditions? The investors in this country know what the conditions are. These reports are all published. The Government publishes its reports frequently.

The conditions are there for the people to see, and in my observation, in the open markets of this country, people see them frequently, much before we do here in the Congress of the United States.

Therefore, I ask you if it is not wise and in the public interest, in your opinion, for those of us who see the dangers when they are there, who do see flammable material lying around, is it not in the public interest that these things be called to attention, rather than to try to hide them or make believe they are not there?

Mr. MARTIN. I think I have already answered that question. I think one should be extremely responsible in whatever statement he makes, and we should be very careful not to magnify the dangers or minimize them.

Senator BUSH. I certainly agree with that. You have said in your statement words to the effect that stability breeds confidence. You say the experience of the Government bond market, to which I alluded, is a vivid example of the influence of inflationary expectations in financial markets.

This is in evidence of what I have already said that investors are quick to determine conditions which they think affect their investments, and that they act promptly. But I think stability does breed confidence. Holdings of investors of Government bonds are similar to holding his savings in a bank. If the depositor loses his confidence in that deposit, then he wants to get it out and he does so.

Now, the conditions which may make that deposit in a hazardous situation sometimes are kept secret for a long time through the efforts of the management, the directors, and so forth. Sometimes it is a good idea. Sometimes they work out a difficulty that way. But once the fear of losing the savings is recognized, then the line forms and there is nothing in the world to stop it, at least it usually results in a bank having to call.

Now, I suggest that the savings of individuals in connection with the Government bond market are very much the same thing, and what we have got to do is to maintain confidence and we have to maintain confidence by insisting that we have a stability of the dollar.

Do you not agree with that?

Mr. MARTIN. I do.

Senator BUSH. You are aware of the fact that we have before the Congress an amendment to the Employed Act of 1946. I do not have the exact language of the amendment. I think Mr. Martin is familiar with the amendment, but the purpose of the amendment is to make relative price stability a condition precedent to obtaining conditions of maximum employment.

In other words, this act would be fortified by recognition of the fact that a sound currency and relative price stability is a condition which makes for confidence, and therefore makes for conditions of full employment.

Do you care to comment at this time upon such amendment to the Employment Act?

Mr. MARTIN. Well, I think the amendment would be desirable and we support it. I am not certain that it is necessary, let's put it that way. In the sense that I interpret it, the phrases that Senator Douglas used before—maximum production, maximum employment, maximum purchasing power—to me they are inseparable. Those are part of the Employment Act as I read it today.

Now, Senator Douglas and I went over the preamble to the act a number of years ago, as you know, and I am inclined to think that the history of the Employment Act, of which you, Senator, are more familiar than I, seems to me to be consonant with that.

Senator BUSH. Your thought is that it would be desirable, but you are not sure it is necessary?

Mr. MARTIN. I am not sure it is necessary, and I certainly think we should never make stability an end in itself. We want money to be our servant and not our master, and the only reason we want stability is to attain this growth and development we are seeking.

Senator BUSH. I think that is very sound; and, of course, the purpose of the amendment is exactly that, not to attain stability for its own sake, but only because it would have a desirable effect upon maximum employment.

The CHAIRMAN. Mr. Bolling?

Representative BOLLING. Mr. Martin, in your colloquy discussion with Senator Douglas you said that on occasion you had admitted error.

It seems to me that I remember in one of these hearings I heard you admit that you felt—I think it was in the 1953–54 period—you had gone to a policy of ease too quickly.

Mr. MARTIN. We maintained the policy of ease too long. That is a little clearer.

Representative BOLLING. That is right. I have listened to you for a number of years. At this particular time of the hearing I wonder if you ever admit that a policy that you had had, had been too restrictive?

Mr. MARTIN. Well, I can't think of any particular time, but you must realize, Mr. Bolling, that we make adjustments through the open market continuously.

Representative BOLLING. I understand that.

Mr. MARTIN. And from time to time, at open-market meetings, we have decided that too much pressure had been put on and reversed it. Now, obviously, the nature of our function—the last thing I would ever want to do is appear before this committee or any other committee and say that we are perfect.

Representative BOLLING. I know you would not say that, but it occurred to me that your admissions of error had been that you were too easy, rather than too stringent.

Mr. MARTIN. I just make one comment on that. In the period we have been going through in the nearly 8 years that I have been in the Federal Reserve, in my judgment the problem has been fighting the next recession, because the elements of growth and development in the economy are running ahead of what can be sustained.

There may be another period of time when that is not true; but the population growth and other factors that have characterized the period since the adoption of the Employment Act in 1946—in my judgment, the really effective way to obtain the objectives of the Employment Act and to minimize recessions and stabilize employment has been to dampen it down.

Representative BOLLING. Now, I have a different line entirely, Mr. Martin. You mentioned, I believe, either in your statement or in answer to a question, something in the order that it was a lot of inflammable material lying around.

Would you, in the light of the fact that as far as I know everybody agrees that there is a very substantial excess of capacity over demand, that there is a substantial amount of unemployment beyond what I would call seasonal employment—would you be quite explicit in describing that flammable material?

Mr. MARTIN. The first item is the savings and investment process as exemplified in the conviction, the growing conviction of people through the last few years, that we would not follow the seesaw, as I put it, that when times were good we would not do anything in the direction of stabilizing the budget and accumulating a little bit of fat for the day when the seesaw turns the other way. We would always lean on the side of the increasing deficits and pressing on this end of the seesaw when it turns down [indicating with hands].

Now whether it is justified or not, I don't think it is justified in any extent fully. The savings and investment process has been damaged recently by the feeling of people that this is a course that is going to be pursued by both parties, and irrespective of any other developments in the economy; and I think it has an impact on the investment market which has to adjust to the level of savings, which is adequate to sell Government securities at lower than the present rates, but those rates do not prevail. There is no market for Government securities because people say that this inflation is inevitable.

Now the liquidity factors in the economy are partly brought about by us. That is another important part of the flammable material here. We have expanded the money supply. I believe that the money supply is in good shape. I sound now like I am boosting the Federal Reserve. I do not intend to, but I honestly think that we have done an effective job in stabilizing and expanding the money supply during the recession.

I wish the recession hadn't been as sharp and as abrupt as it was, and I thought it wouldn't have been had we not had the preceding inflationary buildup, but that is a process which had been going on for a period of years.

At the moment, you can't stop this at a period of time. When you look at the period 1947 to date, we have had a 30-percent increase in our price level, roughly, and no assurance, in my judgment, that that trend has been halted.

Now those are the elements of the flammable material.

Why did we develop this temporary overcapacity?

Let me say that I think it is only temporary. I think the growth elements in the economy and the future are brighter than ever as we approach the 1960's.

We got it because of the expectations of inflation and the way things were running ahead, and the fact that our price adjustments—as I tried to spell out on the price point here, you should not have price rises when demand falls and wages rise when unemployment increases.

Now, that is one of the basic factors that we have to deal with.

Representative BOLLING. Thank you.

Now, this, in effect, if I understand correctly, means that merely what we have here, the inflammable material is psychology.

Mr. MARTIN. Not entirely. Let's take it in terms of our foreign trade. I think sometimes we overlook the fact, because we haven't been faced with the balance of payments problems that some of our foreign friends have been faced with. We are not a closed society.

I don't say we have priced ourselves out of the market. You read that statement from time to time and I have been trying my best to follow the situation. But I say competitively, in the world markets, we are getting in a more difficult position, and we are going to have to have to adjust prices if we want to compete in that market.

Now, this cost-price push is continuing. The inventory liquidation that occurred before has stopped, and now we are beginning to talk about an inventory buildup.

We have talk about a possible steel strike, and an additional wage demand in the summer. I do not know whether they will or will not materialize, but they are all part of this price-cost push which makes it more difficult for Americans to compete abroad and which is a real factor in long-range employment in this country.

It is one of the factors that gives me real concern for jobs.

Representative BOLLING. Wouldn't it perhaps be more advisable, from the point of view of total policy, to try to attack the problem? By that, I mean the basic problem. Many of these areas, the rigidities that affect us in world markets are based on subsidies of various types, not just the farmer, but the businesses of all kinds and varieties, at least in some of the areas I can think of offhand where we are pricing ourselves out of the market.

For example, the merchant marine is a direct result of a specific Government policy to keep the price up. It seems to me that perhaps, looking more at the problem of inflation and growth, that the more constructive approach—this is not your problem, obviously—would be to get at the rigidities with a realistic assessment of Government policies.

Mr. MARTIN. I couldn't agree with you more, Mr. Bolling.

Representative BOLLING. One other thing. Now this does seem to be mor psychological, but very largely with a substantial element of psychology in it. Do you consider the economy to be reasonably healthy today?

Mr. MARTIN. I don't think that the economy is where it would have been or should have been if it had not been for the inflation that has been in the economy for the last 7 or 8 years.

I think that we have made an amazing progress considering the amount of instability that there has been.

Representative BOLLING. You do not feel that the economy has been irreparably damaged as yet?

Mr. MARTIN. Not as yet; but I think it is important enough to consider both the pricing aspect that you have raised and the monetary problem that I have raised, and that it warrants our serious consideration and thought so that it won't happen.

Representative BOLLING. Well, actually I think this process has been going on for a good deal more than 6 or 8 years. It has been going on since 1933, at least according to the tables that I look at.

Mr. MARTIN. I think it was damaged very badly during the 1930's. The heritage of all war is inflation and the period since World War II is one in which we have not found any satisfactory way of unraveling the knots that the wartime inflation has caused for us, and we want to be very alert to fight the recession and adjust ahead before things get out of hand, so that we don't have a real sharp—I don't know the difference between recession and depression, except in degree.

Representative BOLLING. Just one last question. You feel, do you, that it is possible to have—I think the phrase used in the Economic Report of the President is "reasonable price stability with vigorous growth." Would you define "vigorous" yourself as 4 or 5 percent per annum, average?

Mr. MARTIN. Well, we can get into a discussion on that. I really do think we can have vigorous growth and price stability. I think we will have a greater growth than we will have by a fixed program.

You have to try to put this in terms of broad concepts. Our programs, and we don't have projects as such in the Government—and that is one thing I have chafed under in the Federal Reserve, and that is we are not coming forward with programs in the Federal Reserve to achieve a given project.

We have tried to work in a climate and an environment out of which free enterprise will produce growth and development.

Now if you are going to go to the other extreme, and I am not trying to put it in extremes at all, but if the Government is really to set the level of growth and the Federal Reserve is to adapt its policy for forced draft or forced feeding to get that sort of growth, then I think what you really come to in the long run, and I am not trying to state it in an extremist way, is that the Government will have to get in business a whole lot more than just the Defense Department, State Department, foreign aid, and the subsidies in the foreign aid program. It would have to accept the responsibility for growth generally in the private sectors of the economy.

Representative BOLLING. I couldn't avoid a comment on that, that the Government has introduced itself into other fields than those mentioned, but ordinarily we are too polite to admit it.

Mr. MARTIN. I understand that, and I am deploring it.

Representative BOLLING. Thank you.

The CHAIRMAN. Senator Javits.

Senator JAVITS. I welcome you as a fellow New Yorker. This is my first time on the committee since you have been a witness and I am glad of the opportunity to have a chance to compare notes with you.

I was a little late because I was delayed and so I have relied on my knowledge of what you have said in your own written statement. I hope you will forgive me if I refer to that.

In your statement you say:

> Then there is the easy acceptance of the idea that a little inflation is not seriously harmful.

I would like to ask you the same question I asked the Secretary of the Treasury yesterday. Does that mean that you say we ought to follow an absolute adherence to the penny—a totally balanced budget—or is there any room for flexibility? Suppose we are $100 million or $1 billion over. Is that going to change the fundamental stability concept which you are advocating?

Mr. MARTIN. No, Senator, we are not seeking a penny balancing budget operation.

We are trying to put this in the perspective of an important objective. I put in my statement here that I think if we continue the economic expansion—which I don't say necessarily we will, but I think it is possible at the present time—we should have not only a balanced budget, but a budget surplus. And this seesaw, as I like to think of it—it should be clear to the whole world that, as far as our housekeeping is concerned, what we have said to many other foreign countries applies here. That is, when you are riding high and doing well, you are going to have a little fat on your bones and take more than a little look at the possibility of reducing your debt.

You are not going to reduce your debt substantially. You are talking about a balancing factor at the present level of the economy, but you are always going to have your seesaw, and this is a time when we have come out in a very vigorous way from a previous recession. If you are going to have your seesaw so that you think nothing of going down to a $15 billion deficit and then perhaps going substantially further in that direction, you get back to where the economy is regaining everything that is lost in the period, and you have not balanced your budget but actually have moved in the opposite direction. I think then you are in trouble.

Senator JAVITS. I noticed that you used the phrase "prosperous times."

It is a fact, is it not, that these are not normal, prosperous times—that we are in a cold war and a serious one?

Mr. MARTIN. Yes, Senator, let me point that one up for you as I see it.

One of the things we are constantly faced with is people who say that inflation is not the problem, the problem is the cold war. I want to point out that we fully recognize that; but if you are going to adopt the procedures and techniques of the collectivist powers to deal with your problems to win the cold war, you can't help wondering from time to time whether the cold war is worth fighting for.

It seems to me that we have got to face up to whether our system will work. I happen to believe that it is a good one, that it will produce more in the way of growth than will a regimented economy, but in fighting the cold war with a regimented economy, if we are going to assume that it is in effect a hot war and put on all the draft that you put on in times of actual fighting, then I think you have changed the nature of the problem.

Senator JAVITS. I don't think, Mr. Martin, anybody recommends that we put on all the draft. We spent, as I recall, as much as $100 billion a year in World War II. I do recommend that we consider seriously adjusting our financial ideas to the fact that we are in the cold war.

I ask you this question: In your judgment, are you assuming that more sacrifice is required from our people and perhaps other techniques are necessary in Government—of course, without surrendering all our freedoms?

During war, for example, we adopt all these collectivist techniques. We may have to adopt a few now.

I would like your comments.

Mr. MARTIN. Under present conditions, if you need additional expenditures, and I am not passing judgment on whether you do or do not, but if for example you needed a large defense program and a larger foreign aid program or other programs, I think we should adopt taxes or revise our tax program in such a way as to pay for them.

I think that the people that are involved—if it is a security operation—they ought to know they are going to pay for it in some way. I think that is a very vital thing.

Now, at various points, let us say at the time of sputnik, we come along and we say that we are dealing with catching up with the Russians or surpassing the Russians. I don't know whether the Russians are ahead or not, and I am not sure that anyone else exactly knows, but whatever we are doing there, let's say that we ought to do it. We do not want to balance the budget unless it is essential. I say it is essential.

When you reach the point where it is out of perspective, the whole world, in the free sense, is looking at you and saying you cannot even maintain your own housekeeping and you are going the way of a couple of other countries that you and I can mention, before too long, and I think it has an effect on the cold war also.

Senator JAVITS. Mr. Martin, would you go along with me on the proposition that the axiom of our Government should not be balancing the budget alone.

The axiom should be balance the budget and do everything you can to win the cold war and meet the obligations you assume. If they cost more than the budget allows when you assume them, you must be prepared to tax yourself for them, even if it means more taxation. We are not slaves to this budget within the penny or the $100 million. That it is not substantially the principle that we ought to attain.

I tell you this, if that is the posture for the country, it will be very much more understandable and very much more acceptable within the present frame of reference than what I understand the country has from the administration.

I do not think that the country believes that you have to balance the budget to the penny; I don't think that is so, and the sooner we explain that, explain what we mean by the concept of a balanced outcome and outgo, the sooner we are going to get reasonableness and effectiveness in what we are going to do.

Mr. MARTIN. I don't quarrel with you. I don't speak for the administration. I don't know what their position is on the budget, per se, but I think the position is what is the controlling factor here.

Senator JAVITS. I just have one more question, Mr. Martin.

In your statement you have a passage in which you say that you feel we are in a period of economic growth.

Under Government policies and economic growth, you say:

> If past experiences is a guide, then we are on the threshold of a new period of economic growth.

What I would like to ask you is this: Do you feel that we can successfully experience this new period of economic growth at the present interest rate structure, or do we have to make some conscious effort to bring interest rates more in line with the fundamental financial stability of our country, which, in my own opinion, would justify a general lowering of interest rate structures?

Mr. MARTIN. You and I are in agreement, Senator.

Earlier, when you were not here, I pointed out that the level of savings in the country at the present time, in my judgment, is adequate to sell long-term Government bonds at lower than the present rates.

If you can convince the savers that they are not faced with the problem on the erosion of the dollar, then I believe that our own prospects, as the year goes along, are that we can have a satisfactory level of savings. I think that one of the very fundamental elements in the growth that we are all seeking is to get in this perspective that savers believe that saving is worthwhile again, and that the funds will be redirected, not toward hedges against inflation as a great many of them are today, but will be redirected toward more permanent investments.

Senator JAVITS. Do we need lower interest rates in order to really realize what you say in a new period of economic growth?

Mr. MARTIN. I would like to see interest rates lower, but I would say that we cannot achieve lower interest rates by decree.

Senator JAVITS. As credit is based on supply and demand and the U.S. Government is the demand, would you have any suggestions in law which would make us less vulnerable to the immediate situation of supply and demand? In other words, is there any way you could recommend that we could withhold demand for a time until the market gets more easy?

Mr. MARTIN. That has to do with the financing of the Government, and the Government deficit in the first half of this calendar year was $7.5 billion.

In addition, quite apart from any program for balancing the budget, we are running a $7.5 billion deficit in the calendar year 1959, the first 6 months.

That is where the heart of your problem is.

Senator JAVITS. If you had any suggestion on that, I would love to have it myself, and I think we all would. How can you put the Government in a position where it is less susceptible to a situation demanding higher interest rates? Can it hold off for a time and not be constantly vulnerable to the immediate market?

Thank you, Mr. Chairman.

The CHAIRMAN. We are very glad to welcome Congressman Brown of Missouri to our meeting.

Have you any questions?

Representative BROWN. Thank you very much, Mr. Chairman. I always enjoy interrogating my fellow Missourians. [Laughter.]

I think every American is quite disturbed over this inflation problem, and everyone seems to be looking under the bed for the real villain.

I am disturbed a little, Mr. Martin, about the tendency to simplify this problem.

Many of my people hear all the time about the dangers of deficit financing by government, and certainly we are all disturbed about it, but there is a great tendency in the country right now to interpret that as the sole cause.

For example, people say, "Well, if there is a deficit this year, the price of beans in grocery stores is going to go up tomorrow." In 1955, 1956, and 1957 we had a balanced budget in this Government. We have had it on previous occasions, but during those 3 years the cost of living increased 6 points. Is that not true?

Mr. MARTIN. That is right.

Representative BROWN. So the direct relationship is not exactly a cause and effect relationship that tells the whole story. Is that right?

Mr. MARTIN. That is correct. It becomes more important at different times, you see, in the cyclical moves. My personal view is that it is of more importance now than it has been for a long time, because of the recession we went through and the sharp nature of the dislocation and the improvement in our productivity, that we recognize the desirability of reversing the trend on our Federal budget.

Representative BROWN. Now, is it not true that Senator Javits has a good point, that these are strictly not peacetime times, that this is a cold-war period. I could become a hot war at any time. Those are the times we live in.

Mr. MARTIN. I agree with that.

Representative BROWN. Now, during the hot war we financed approximately 80 percent of the Government's expenditures by credit, and 20 percent by current income. It was bad. It was terrible. We paid for it in the form of a hangover, didn't we, an inflationary hangover?

Mr. MARTIN. Right.

Representative BROWN. Now we are financing about 84 percent of our Government expenditures by cash and some 16 percent by credit this year, so that is not yet as bad as it became during the war, is it?

Mr. MARTIN. That is correct.

Representative BROWN. Now, we are trying to get it in balance, but you said something that worried me. You said that if we sacrifice too much of our system in this cold war, that we will have nothing to win by it.

Actually, I happen to feel, and I am sure you feel this with me as a Missourian, that if the price of freedom in the end result is sowbelly and beans, I still want it, don't you?

Mr. MARTIN. I do, indeed.

Representative BROWN. We do not want it to come to that, but in avoiding it, do you not feel that Government can lead, can inspire, can encourage certain trends that will help us avoid catastrophe?

Mr. MARTIN. I do.

Representative BROWN. As an example, when the expansion of plant capacity in this country occurred in the postwar years and we became capable of producing 10 million automobiles, was that not an extreme that results from just everybody going his own direction? Would you agree with that?

Mr. MARTIN. I would.

Representative BROWN. When we built shopping centers that perhaps are a little in excess of the need right at the present time, although as you say we will in time grow up with them, was that not a result of an unchallenged, unguided sort of hit or miss—everybody going in his own direction?

Mr. MARTIN. That is part of the inflationary picture that has brought us to this presence.

Representative BROWN. How are you going to get that leadership, that inspiration, that channeling, if the leadership does not come from the Government?

Mr. MARTIN. I cannot speak for the Government, as you understand. I am trying to put the monetary problems, as I see it, before you. In the President's Economic Report I think they have pointed up suggestions that they believe will contribute to this climate. I do not think that I am the person to comment on any of their programs.

Representative BROWN. Mr. Chairman, I want to say as a guest at your hearing, and I appreciate so much being here, that if I can comment and say that we can become so concentrated on this problem of inflation and certainly it is great, that we might lose sight of just what we are trying to do as a people, together. We must grow, mustn't we, Mr. Chairman?

Mr. MARTIN. Yes, and I think that the way to grow and the only way that we will grow commensurate with our resources and strength, is to avoid inflation.

Representative BROWN. I share that goal, but if we concentrate 90 percent of our energy toward stability in putting the lid on, we may handicap this great country and this great system of ours, which I do not believe has even begun to realize the great potential that it has.

Mr. MARTIN. You and I are in complete agreement on that. I will just say "amen" to that.

Now, you mentioned the automobile industry and other industries. I am not talking about a given industry, but the problem has been that the reason we are not realizing this potential is that we have tried to run too fast at times and ignore commonsense economics.

Representative BROWN. Might I suggest this, Mr. Martin, that if some people had been told that there was a greater opportunity for investment and a greater overall need for investment or some product of that kind, rather than just keeping plowing money into the old established industries that are so-called blue chip, would we not be a little further along the road of a lot of capacity that we can't use in 8 or 10 years?

Mr. MARTIN. Assuming the people who made the judgment and gave the leadership were right in those judgments.

Representative BROWN. Is it not an interpretation of just a need? Everyone can read the facts. I mean the people in leadership should be able to, at least.

Mr. MARTIN. I can only say on that that certainly during the last few years, to the best of our ability in the Federal Reserve, we have tried to point up that the most effective way to combat a recession ahead is to resist the inflationary pressures that precede it.

Representative BROWN. Thank you very much.

The CHAIRMAN. We will have an opportunity for a quick question all around.

Mr. Kilburn?

Representative KILBURN. I have no questions.

The CHAIRMAN. Mr. Patman?

Representative PATMAN. Mr. Chairman, I wanted to make my position clear on the short-term securities sales to the Federal Reserve.

I am not advocating that as a policy all the time, but I am advocating it if the Government attempts to sell Government securities, and, after all, the individuals in corporations, including investment, trust, pension funds, insurance companies, after everyone has had an opportunity to bid and obtain these securities, then, if you must, if you are compelled to get additional money, instead of going to the private commercial banks and allowing them to create the money on their books of their banks with which to buy these bonds, that part should be acquired from the Federal Reserve, and you would save the interest incidentally on that much of the Government debt.

Then, we would have the help of all these fine people in paying that off first.

They would want that out of the way right quickly. You would have their support in paying off that much of the debt.

Like it is now, we can't have any help in trying to pay off the debt. We have no planned program for paying the debt off. We ought to increase taxes, if necessary, to reduce this debt, but there is no effort made, no sentiment in favor of it because it is so profitable to carry it.

If we had a part of that debt, in part of the Federal Reserve bank, all of the bankers, all of the financiers, they would be dogging us every day to pay off part of that debt, and I think we would and it would be a saving that way.

I cannot understand why people can oppose, for instance, $300 million housing for veterans that we passed in the House the other day when, at the same time, we turn right around and those same people do not look with disfavor on the banks creating, on their books, enough money to buy $10 billion worth of bonds in 1 year without any cost to the banks, and upon which they can receive $300 million a year.

That has been confusing to me. I cannot understand that. Two percent of the banks bought $7.5 billion worth of Government securities.

I do insist that we should consider when we have sold all the bonds we can, when we have acquired all the money we can for the Government, and then it is necessary that money be created, I think the Federal Reserve banks which are in the business of creating money should create that money rather than the commercial banks.

I just wanted to make my position clear.

Mr. Martin. I might say that you handled that very well when you were chairman of the committee in 1952. You remember that you and I disagreed then about that.

Representative Patman. Thank you, sir.

The Chairman. I would like to raise a technical question which might take more time than we have here, but I would like your general comments, either now or later, on this proposal. You have the three classic methods of checking recessions, and maintaining stability in the price level, namely by open market operations, changing member banks reserve requirements, and by raising or lowering the rediscount rate.

In changing the rediscount rate you, of necessity, influence the rate of interest.

I have come to feel that it would be desirable if the Government were neutral on the question of interest rates.

I criticized my own administration, as you remember, for artificially depressing the interest rate in early 1951.

I am very frank to say that I think the Treasury has artificially raised the rate in recent years, and when the Federal Reserve raises the discount rate, of necessity, you raise the general interest rate.

Your purpose in this, of course, is to diminish the demand for funds and hence tone down the level of activity. When this is done, in a period of considerable unemployment and idle capacity, however, the result is to hold back full recovery.

I had wondered whether the Federal Reserve Board's aim of following policies which would help to stabilize the economy and offset both inflation and deflation could not be obtained directly through open-market operations; namely, that when you want to expand the currency, you would purchase Government securities and build up member banking reserves, and when you want to contract, you would sell Government securities, and therefore shrink member banking reserves. Then let the interest rate be determined in the open market with the Government and the Federal Reserve neutral on that issue.

Have you given consideration to that?

Mr. MARTIN. You would eliminate the discount and try to have the open market operations do the same thing? We will give you a memorandum on that.

(When received the material referred to will be available in the committee files.)

The CHAIRMAN. Will you be willing to shoot from the hip on it now?

Mr. MARTIN. I don't think you can administer the discount window—you change the whole operation.

The CHAIRMAN. You are not compelled to accept the Government bonds that are presented to you. That is optional on your part.

Mr. MARTIN. That is true, but the administration of that window gets to be very difficult.

The CHAIRMAN. But you can simply close it down.

Mr. MARTIN. Well, there are many instances if you did that where you would work a real hardship on individual banks.

You have to think of each of these in relation to the needs of the particular bank. If you just shut it down as a general control—I think it has a real weakness, that is, I mean your suggestion has a real weakness, Senator.

The CHAIRMAN. It is 11 minutes past 12. It is not the time for a long discussion, but I think there is more to it than you seem basically to believe.

I think it would have this great advantage—it would remove the struggle over the interest rates from the political field.

I am very frank to say that this administration has boosted it and that many of your actions have contributed to its increase.

Perhaps it should be a matter of public policy, but I would like to see at least an experiment made with the Government neutral on the question of the interest rate. You could use the tool of buying and selling Government bonds as an instrument of control, but have the interest rates adjust in terms of the supply and the demand for bonds.

Now, if you and your experts have time, I would appreciate it if you would present a memorandum on that.

Representative PATMAN. May I interrupt. In the same memorandum I wish you would state your opinion of the Federal funds market that are available now, and this comparatively new market, Mr. Martin, where you state it would be a squeeze on many banks without the discount window which is now seldom used, as you know, that the Federal funds are available in New York now at the same rates that the banks would have to pay the Federal Reserve. Is that not so?

Mr. MARTIN. I think that is about right.

Representative PATMAN. So they are really bypassing the Federal Reserve, it seems to me, and I would just like to have your memorandum to cover that.

Mr. MARTIN. I will be very glad to prepare you one.

Representative PATMAN. And also in the bank deposits.

Mr. MARTIN. Yes.

(When received the material referred to will be available in the committee files.)

Representative PATMAN. It seems to me the bank deposits have increased rapidly and that we are approaching possibly the same level that existed prior to the passage of the Federal Reserve Act when too much money was concentrated in too few banks.

Mr. MARTIN. Well, we will be glad to cover both of those parts.

The CHAIRMAN. One final question. The New York Federal Reserve Bank is the fiscal agent of the Treasury, is it not?

Mr. MARTIN. That is correct.

The CHAIRMAN. Now, in its relationship with the Treasury, do you exercise any supervision over its activities?

Mr. MARTIN. I do not think we can, by law. We, of course, have general supervision over the bank, and the salary structure and that sort of thing in the bank, but the law provides that the Treasury—that the New York Federal Reserve Bank is the fiscal agent of the Treasury.

They cooperate with us in keeping us informed, but I don't think——

The CHAIRMAN. The president of the bank wears two hats then. He is the fiscal agent of the Treasury and he is also the head of the Federal Reserve Bank, which is under your general supervision.

Mr. MARTIN. That is correct.

The CHAIRMAN. Do you think that relationship needs to be gone into?

Mr. MARTIN. We so recommended at the time of the Financial Institutions Act.

I have not always agreed with the Treasury on that, but I don't think they think so. Personally, I think it is a weakness in the present law.

Representative PATMAN. May I interrupt again?

Now, notwithstanding the fact that it is a fiscal agency, there has never been an independent audit made of the Federal Reserve Bank of New York, has there? In other words, the General Accounting Office of the U.S. Government has never made any audit of a Federal Reserve bank of New York, and the only audit ever made is one selected, the auditors were selected by the officers and directors of the Federal Reserve Bank of New York themselves.

They selected their own auditors and gave them their own directions and those reports have never been available to Congress until the last year or two.

Mr. MARTIN. The last few years they have been available and I insist, Mr. Patman, that we are one of the best auditors anywhere.

Representative PATMAN. They are your own auditors; you pick them.

Mr. MARTIN. I think you will find our audit system and control system is extremely good.

Representative PATMAN. I don't doubt but that you use great care in picking the best auditors you can. You pick them and you give them instructions and it does not seem to me that it is a good way to run a business.

Mr. MARTIN. We send up what the instructions are, and we added the outside, individual auditors.

I think one of the primary purposes of the Federal Reserve Board is to do that for the individual banks, but in addition to that we have now brought in independent auditors from the outside and they have gone in and made independent audits of individual banks to check our procedures.

Representative PATMAN. And made reports to you, yourself?

Mr. MARTIN. Now, the General Accounting Office does not audit us, and if you will go back to the Banking Act of 1933 and 1935, it was steadily debated, as you and I both know, at that time, and it was decided that we would not be put under the General Accounting Office. We were given that flexibility.

Now, neither you nor Senator Douglas have agreed that that was a wise decision, but that is as it is today and I have steadily maintained that, in my judgment, it is a correct way.

Representative PATMAN. But the amount of business done, then, as compared to now, was peanuts. I think a great mistake was made and I hope the Federal Reserve Board will not further insist on opposition to the proposals to audit thoroughly the Federal Reserve System, including the Federal Reserve Board and the Federal Reserve banks.

Mr. MARTIN. Your position is well known there, Mr. Patman.

Representative PATMAN. Your opposition is well known, too.

The CHAIRMAN. I was privileged to spend a few days at the control center for the open market operations.

Mr. MARTIN. We appreciate that, Senator.

The CHAIRMAN. I was struck with the fact that you had a limited number of dealers from whom you bought, or to whom you sold. I think at that time it was 12 or 15. Is that right?

Mr. MARTIN. That is right.

The CHAIRMAN. And you dealt with each of these at arm's length with a separate telephone connecting the control center with each of the dealers, and I wondered if you had ever considered the possibility of a central board of trade where all the dealers would be brought together and where the purchase and sales of Governments would be allowed—it would be quite open—by competitive bidding.

Mr. MARTIN. We have actively considered it, and it is being considered at the present as a possible method of operation.

It is not an easy problem to work out; having come out of the stock exchange, I at one time thought it would be desirable to have it on the stock exchange. You see, there are different types of markets. This is not an auction continuously.

The CHAIRMAN. Has your study progressed far enough so that you could present methods and the advantages and disadvantages of a central place where competitive buying and selling could take place?

Mr. MARTIN. If you will give us some time on that. We are in the process of collecting a lot of material.

The CHAIRMAN. You think you could do it in a span of 2 or 3 months?

Mr. MARTIN. I think so.

The CHAIRMAN. And then submit it to such other committees of Congress as might care to see it as well?

Mr. MARTIN. We would be very pleased to do that.

Representative PATMAN. One other things, Mr. Chairman, including the advisability of you selecting 16 dealers for the dealers all over the country—I won't call them pets of the Federal Reserve, but they are given special treatment, I think, because they are even allowed to borrow money from the Federal Reserve banks to finance their operations.

So, you not only have the telephone connecting up with them and dealing with them all the time, but you are furnishing them the money. I think it is in violation of the Federal Reserve Act myself, and I think that you probably realize it, your Board did, because last year you asked that it be legalized.

You asked last year that the law be changed so that you could make loans to these dealers, but you still make them anyway.

Mr. MARTIN. That is a moot question, Mr. Patman; we have made repurchase agreements available for many years, and that was a bill for clarification of the authority.

Representative PATMAN. But age doesn't make anything legal. I do not think that you would insist on that, would you?

Mr. MARTIN. Not just age; no.

Representative PATMAN. Well, in this case, you are furnishing them the money to deal with these securities.

Mr. MARTIN. We are helping them to finance their operations in order to facilitate the functioning of an important market.

The CHAIRMAN. Thank you very much, Mr. Martin.

The discussions will be continued this afternoon at 2:30 in this room, and Mr. Seymour Harris, of Harvard, will present a critique of your remarks.

(Whereupon, at 12:20 p.m., the committee recessed, to reconvene at 2:30 p.m., same day.)

AFTERNOON SESSION

The CHAIRMAN. Dr. Harris, we are very appreciative for you coming down from Cambridge in order to present your views, and because you had to rearrange your schedule. You have a very busy life and we are very appreciative. Thank you very much.

## STATEMENT OF SEYMOUR E. HARRIS, CHAIRMAN, DEPARTMENT OF ECONOMICS, HARVARD UNIVERSITY

Mr. HARRIS. Senator, will it be all right if I submit the statement for the record?

The CHAIRMAN. Yes. It will be printed for the record and then you may comment orally upon it if you like.

(The statement referred to follows:)

STATEMENT ON MONETARY POLICY BY SEYMOUR E. HARRIS, CHAIRMAN, DEPARTMENT OF ECONOMICS, HARVARD UNIVERSITY

At the outset I should like to make two points. First, the obvious one, is that I am speaking for myself and not for my university. The second is that, though I am critical of recent monetary policy, I do want to say that I admire Mr.

Martin, Mr. Mills, and their colleagues for their courage and candor. They have shown much more courage than the Federal Reserve showed, for example, in the 1920's.

*1. Objectives of monetary policy*

The objective of monetary policy, according to statements by the Chairman of the Board of Governors of the Federal Reserve, by Secretary Humphrey before the Senate Finance Committee, where the administration views were fully aired, and even statements by the President himself, suggests that the most important objective of economic as well as monetary policy is stability in the value of the currency. In this sense, there is no independence for the Federal Reserve, because the Federal Reserve's position is that of the administration. Indeed, increasingly the objective of growth is mentioned, but it certainly does not play the vital part in the administration's policies as it should have.

Obviously, these are matters of degree. We would all accept a 10 percent rise of output per year and a 1 percent inflation as a very effective policy; but an increase of prices of 10 percent and of output of 1 percent would be considered an unfortunate policy. The recent discussion of whether we want a 5 percent growth and some inflation or a 1 or 2 percent growth and no inflation, I think, well reflects the difference of viewpoint between the administration and some of its critics.

In this connection, we should perhaps present the following table.

*Rise of gross national product, cost of living, wholesale prices, and the relationship between the rise of GNP and the rise of the cost of living*

[Percentage changes]

| | Annual rise of real GNP | Prices, cost of living | Wholesale prices | Excess of percentage rise of GNP over rise in cost of living |
|---|---|---|---|---|
| 1948–52 | 5.50 | 2.5 | 1.75 | 120 |
| 1952–58 | 1.75 | 1.5 | 1.20 | 17 |
| 1948–58 | 3.50 | 2.0 | 1.40 | 75 |

I do not mean to say that stability and growth are the only objectives of our economic policy. For example, an even more important objective than either of these might be the security and survival of the Nation. It is conceivable that in order to be secure we may upset our objective of stability. Ordinarily, the objectives of growth and security are consistent, but those of stability and security are not necessarily always consistent.

Another objective is equity. Here again it is conceivable that the educational system or the housing situation or that of our depressed areas may be so bad that we may have, to some extent, to sacrifice stability in order to achieve a better distribution of expenditures. These, of course, are all matters of judgment and degree.

*2. Is our system stable?*

On the whole, in the last 10 years our record has not been bad, even on grounds of stability. The average rise in the cost of living has been 2 percent and in wholesole prices 1.40 percent. Should we eliminate the effects of the Korean war, then the average rise in these 10 years in the cost of living would be 1 percent and in wholesale prices one-half of 1 percent. In the same period we had a rise of output in real terms of 35 percent. This is surely not a bad record and compares favorably with earlier ones. In fact, it is a much better record than that from 1896 to 1913. One must remember that major rises of prices occur in wartimes, and this was also true in the last 10 years. It is not easy to have stable prices in wartime.

We can also raise the question whether in fact the price rise has been as large as it is sometimes held to be. Our index numbers are not perfect. It is not clear that our inflation is even so large as is suggested by the index numbers. In the compendium before the Joint Economic Committee, Professor Ruggles, of Yale, argued as follows (pp. 298–299):

"* * * Prices are obtained for commodities of fixed specifications. In fact, however, new items continue to appear on the market, and old items change in quality. When improvements in quality cannot be measured, and new products appear which are more desirable than those they replace, price indexes which must leave these factors out of account will show too much price increase. * * * But improvements in quality may occur at no increase in cost, so consumer gets more value for his money. In such cases, no adjustment is made in prices and the price index does not reflect the quality improvements. * * * Suppose an individual were given $1,000 and a choice of ordering goods either from an early postwar Sears, Roebuck catalog (say 1948) or a current (1957) catalog. If he were permitted to spend the money in terms of only one catalog, which catalog would he choose? The 1948 catalog has substantially lower prices, but also less advanced products. In the 1957 catalog which was shown, it could not be said that prices rose from 1948 to 1957, despite the evidence of the price indexes."

*3. Treatment of inflation by the monetary authority*

In the past, the major cause of inflation has been an excess of demand, that is, the total amount of spending in relation to the flow of goods and services tends to send prices up. In the last few years much has been made of the point that inflation is caused by a cost push. The question immediately arises whether we should treat an inflation brought on by a cost push in the same way as one brought on by an excessive demand. It is not clear to me that the Federal Reserve has adequately recognized the differences in these two types of inflation nor its responsibilities relatively to one as against the other.

The President and the Council have also suggested that labor should be more restrained in its demands and that everything should be done to increase productivity. Of course, we all agree that any gains in production would be an offset to the rise of prices to the factors of production.

I should say parenthetically that there has been a campaign, supported to some extent by the administration and also by many others inclusive of eminent journalists, that labor is responsible for the inflation. I think myself that the contribution of labor to the price rise has been greatly exaggerated.

It must be realized that any increase in wage rates is to some extent offset by a rise of productivity. It has even been claimed that to some extent capital has absorbed the rise of wages. This absorption, however, has not been on a large scale. But perhaps what is more germane is to point out some evidence produced by the Department of Labor in June 1958.

With 1947 as 100, the Bureau of Labor Statistics, in a release of June 1958, pointed out the following for 1957:

[1947=100]

| | |
|---|---|
| Wages and salaries per dollar of real product (1957) | 130.6 |
| Nonlabor payments per dollar of real product [1] | 129.9 |
| Average hourly wages and salaries | 166.9 |
| Average hourly compensation in constant purchasing power | 135.2 |
| Average hourly wages and salaries in constant purchasing power | 132.8 |
| Real product per man-hour, all persons, total private sector | 137.0 |

[1] Obviously, the nonlabor contributions to inflation have been relatively just as great as labor's.

In a very interesting study, Miss Ruth Mack, of the research staff of the National Bureau of Economic Research, has shown that labor is not primarily responsible for the rise of prices. Between January of 1947 and the 1956 or 1957 high point she writes in the committee's compendium (p. 130):

"* * * Spot market prices fell by 10 percent of their 1947–49 average, crude materials rose by 16 percent, and all manufactured goods rose by 34 percent. * * *

"Labor cost does not explain these divergent trends. Between 1947 and 1957, according to the indexes prepared by the staff of this committee [Joint Economic], labor cost increased about 15 percent of its 1947–49 average. In other words, the cost of labor and the cost of crude materials rose at about the same rate, and both rose substantially less than did the prices of manufactured goods.

"* * * What, then, is the explanation of the divergent trends? It does not lie primarly, of course, in bulging profits. Rather it must be found in the increasing amounts of fabrication to which materials are submitted, increased marketing costs, increased administrative costs, costs of research, of insurance, of development. These shifts in products and in cost structure thrive in the general atmosphere of the times. Many of the emphasized costs are of the overhead or burden type. There is a widespread belief that the strong upward trend in demand is truly durable. This weakens usual fears of saddling a business with heavy overhead-type costs. * * *"

Perhaps the crucial point is, in the face of these cost pushes, whether it is the responsibility of the Federal Reserve to offset these by restrictive monetary policies and thus bring on unemployment. This is what clearly occurred in 1956–57. Is it also the responsibility of the Federal Reserve to neutralize the effects of governmental policy? If the inflationary pressures are brought on by wage contracts which are made by 70 million workers and a few million employers and also by the needs of Government, is it the responsibility of the Federal Reserve to interfere with these movements in order to achieve absolute price stability? Obviously, the Federal Reserve has some responsibility for restraint, but the real question is how far? In our economic society it is almost impossible to bring about a reduction in wage rates. Therefore, as a minimum we can assume a stable wage rate in the less effective or less productive or lesser growing industries. In the others, there are bound to be differentials, that is, some wages must rise more than others in order to bring about the proper allocation of labor and other resources. Even in 1958, despite the fact that many labor leaders, like Mr. Reuther, showed great restraint in view of the recession, the UAW obtained wage concessions from the manufacturers. We may therefore assume rising wage rates even in recession. If they are offset by increased productivity or absorption by capital, then we should have no inflation. If they go beyond that point, then the Federal Reserve has to face up to the problem of whether it is prepared to cut output, say, by $50 billion in a few years and reduce the average output by a few percent a year over the years in order to bring about absolute stability?

Not only is this a serious responsibility for the Federal Reserve, but also reflects one of the great difficulties the Federal Reserve has in achieving stability.

*4. Control of supply of money and of spending*

One of the difficulties confronting the Federal Reserve, aside from the cost push, is the fact that it operates primarily on the supply of money, hoping that, for example, in a prosperous and boom period a reduction in the supply of money would raise the rate of interest and also, therefore, increase savings. It should be noted, however, that a rise in the rate of interest also cuts down investment. What is more, the recession was largely explained by a roughly $17 billion decline of investment from the third quarter of 1957 to the second quarter of 1958. This reduction was especially large in inventories and in business plant and equipment. Residential construction also made some contribution here. The resultant loss of gross national product of perhaps $50 billion is to be associated with this decline of investment and the secondary effects as well as with failures of growth in 1956.

Undoubetdly, the prosperous period would have been stopped much earlier had the Federal Reserve been able to control spending as effectively as it could control the supply of money. In one period of several years, the total supply of money increased by 7 percent, but total bank debits, by 30 percent; and in one year the respective increases were 1 and 8 percent.

Indeed, in the "Hearings Before the Senate Finance Committee on the Financial Condition of the United States" (p. 1307), Chairman Martin even seemed to claim that he could control the turnover of money: "We have let the balance of the 2 percent on our 3 percent growth take place out of the velocity of money, the turnover of money, and we have felt that this was about right, though I think sometimes we felt that perhaps we have erred a bit on the side of letting the velocity accumulate faster—it is very difficult to measure—than the situation warranted."

At the same hearings in a discussion with Secretary Burgess, Senator Anderson brought out the fact that the financial intermediaries had increased their lending much more than the commercial banks which were under some restraint. But Mr. Burgess' reply was that this, after all, was good, because what went into these organizations were real savings. (See p. 1143.)

Yet it is important to point out that in one period of 4 years, while the assets of commercial banks increased by 13 percent, those of life insurance companies rose by 30 percent, of mutual savings banks by 20 percent, and of savings and loan associations by 90 percent. Even if the Federal Reserve, therefore, can restrain the commercial banks, it finds it increasingly difficult to control the financial intermediaries. Nor did the Federal Reserve or any governmental representative in the thousands of pages of hearings before the Senate Finance Committee suggest any means of dealing with the financial intermediaries.

Yet it is the financial intermediaries that bring about a relatively large rise of spending in relation to the increase in the supply of money. They obtain cash, often inactive cash, from the public and put this cash to work. Indeed, the Federal Reserve claim that their control of the supply of money ultimately brings about control of the financial intermediaries. But the relationship is indirect and there is a very long lag, as has been evident in the recent years.

If the objective of the Federal Reserve is to control expansion, certainly the liquidity of the economy is a relevant consideration. Here the contribution of the financial intermediaries is important. But the banks also have been reasonably liquid, as has been business. All these factors tend to make the job of the Federal Reserve more difficult. For in 1955, as a result of its policy of ease, the banks, as the Federal Reserve admitted, were able to increase their holdings of public securities greatly. In the ensuing period of restraint, the banks themselves were able to dispose of Government securities, with disastrous effect on the prices of these securities, and substitute commercial loans. In this manner, the banks were able to evade the pressures of the Federal Reserve.

I sense that on the whole the Federal Reserve still is not sufficiently aware of the modern advances of monetary theory, which put much more emphasis on total amount of spending as a factor in inflation than the total supply of money.

*5. Self-imposed limits*

Another obstacles to effective Federal Reserve policy is that the Federal Reserve does not use the weapons that it might very well mobilize. For example, the "bills only" policy is one that I find very difficult to understand. On this issue, President Sproul has been much nearer the truth than the Federal Reserve Board. If one wants to influence the rate of interest, it is much more effective to operate on the long-term securities rather than the short-term. Yet the Federal Reserve ordinarily refuses to operate on the long-term market. Its major reason seems to be a fear of introducing an element of uncertainty into the Government bond market. It does seem to me that the general objective of stability transcends that of the assurance of a favorable market for the dealers in Government bonds. Indeed, under great pressure the Federal Reserve has occasionally waived this self-imposed limitation.

Another limitation that the Federal Reserve puts upon itself is to consider not the total reserves or the excess reserves of the commercial banks as the factor that determines their activities but rather what it calls the free reserves. The free reserve is the difference between the excess reserves, that is, the excess over legal requirements, minus indebtedness to the Federal Reserve banks. In the twenties, a theory was developed that the Federal Reserve could impose a restraint by getting the member banks into debt. This theory was developed in part because the Federal Reserve found some obstacles in influencing the total reserves of member banks. Undoubtedly, there is something to this theory, though I think its potency is considerably exaggerated. I am impressed by the fact that after 1 year of recession (by the summer of 1958) the reserves of member banks, as well as their excess reserves, were virtually unchanged. This does not suggest to me a very effective antirecession monetary policy. I fear that the great fear of a future inflation had something to do with this stability in the total volume of reserves of member banks.

*6. Problems of integration*

It is not only the Federal Reserve that influences the money rate and the amount of spending. The Treasury and governmental credit agencies also have a considerable effect. It is not easy to find a consistent policy among these various agencies and departments.

In 1953, it will be recalled, Secretary Burgess introduced a high-money-rate policy through the issue of his famous 3¼ percent bonds. The Federal Reserve acquiesced, though it is not clear how enthusiastically.

It is a generally accepted theory in economics that in periods of booms, when the Federal Reserve is trying to increase the rate of interest, if this is the appropriate policy, the Treasury cooperate by issuing long-term securities and thus absorb excess amounts of cash. In this way, the Treasury also contributes toward the higher rate. But when confronted with this particular issue before the Senate Finance Committee (p. 728), Secretary Burgess could only say that the market did not want long-term Government bonds. "They regarded Government bonds as a secondary reserve at the moment. The demands of their customers are so great that they are trying to meet them as their first responsibility." Therefore, the Treasury issued short-term securities, not long-term.

In the current recession, of course, the correct policy would be to issue short-term securities. Yet I quote from the "Economic Report of the President of January 1959" (p. 44): "In the first 6 months of the year, $19.6 billion intermediate and long-term securities were issued, which resulted in a significant increase in the average length of the outstanding marketable debt." Is it any wonder that the rate on Government securities has gone up so and that we have not had the maximum lift from reduced rates that we should have had by now?

Along the same lines it may be noted that as the President's Council points out, in mid-November of 1957, the Federal Reserve finally reduced its discount rate from 3½ to 3 percent, thus "signaling a decisive change in policy" (p. 36). But, on page 38, the President's Council points out all the numerous strong measures taken by the Housing Administration in order to increase the supply of housing and make the purchase of housing easier. These measures began in August 1957, when minimum downpayment requirements on FHA-insured loans were reduced by administrative order.

One can go even further and point out the President's great concern over inflation and the need of the Federal Government showing great restraint and leadership. The Federal Reserve fearing an inflation, had already increased its discount rate in the summer of 1958. The Federal outlays for 1959–60 were to be reduced by $3 billion and the budget to be balanced. But contrast the volume of Federal loans and guarantees and we find an entirely different policy. The Federal credit agencies have increased their loans since 1953 from 19 to close to $28 billion. But the most startling increase is of guarantees from $31 to $69 billion. And even in fiscal year 1960, it is anticipated that loans will rise by only $1 billion but that guarantees will rise by $9 billion, bringing total guarantees up to $69 billion. Throughout this whole period, both in periods of ease and of prosperity Federal credit programs have continued to grow. One may ask why these strikingly large increases in guarantees. There is much to be said for them in order to achieve the maximum output of housing. But I suspect one important explanation is that an increase of guarantees, irrespective of what it does to the demand for resources and to the price level, dose not count as budgetary expenditure. Loans do, however. Therefore, the greater interest in guarantees.

7. *Failures of monetary policy*

We can judge the net results of monetary policy by what has been accomplished. From 1955 to 1958, the consumers' price level rose by 8 percent. In this same period, there was virtually no net change in gross national product (in stable prices). We anticipate annual increases of at least $15 billion in the gross national product as a result of increased productivity and the rise of the numbers in the labor market. In the 3 years 1956–58, gross national product was $4, $14, and $30 billion below what might have been achieved, or roughly $48 billion. A further deficit below the growth from 1955 to 1959 is anticipated.

In this sense, the policy failed, because not only was inflation not stopped, but a recession followed. Indeed, the Federal Reserve probably contributed to a slowing up of the price rise. But was this worth the recession? The recession should not be put wholly at the doors of the Federal Reserve, because there had been an investment boom which undoubtedly had contributed toward the recession. But the recession itself and the excess capacity are themselves functions of demand. Once the monetary authority cuts down demand, that in turn increases excess capacity. For this reason, I am not very much convinced by the analysis in the "President's Economic Report," in which it is shown that "in manufacturing alone spending on new plant and equipment between 1953 and 1957 had increased capacity by about one-fourth, but production had increased by only 7 percent" (p. 12).

Monetary policy is generally supported because it is supposed to be a general approach that does not interfere with the allocation of resources in any specific way. Yet this is far from the truth. Consider various markets, for example.

First, let us consider the Federal securities market. In 1951, an important accord was made, which was undoubtedly justified. The Treasury had exercised altogether too much influence in the determination of the supply of money as a means of pegging the price of Government bonds. But more recently the reverse policy has come into being, namely, a disregard of the price of Government securities. The high money rate policies had a significant effect here. In his testimony before the Senate Finance Committee (pp. 1237–1238), Chairman Martin said he was not afraid that higher rates would induce large disposals of

Government bonds by banks and financial institutions. (They would be deterred by falling prices.) Actually, from 1954 to 1957, the financial institutions disposed of $19 billion of Government securities, and of these $19 billion, $15 billion were purchased net by other buyers. But sellers had to make large concessions in prices.

Second, consider the State and local governments. They have had considerable problems, in part because their debt has been increasing by about $3 billion a year and possibly $4 billion next year, and in part because of the Federal Government's unwillingness to assume certain responsibilities. These governments have already suffered because the tax exemption privilege does not yield in lower interest rates what it used to. This is the result of a great increase in these securities, the rise of competing securities; and also the greater availability of other means of avoiding taxes. Therefore, the issues of these securities have to appeal to lower income groups for whom the privilege of tax exemption was not nearly so great as for the high-income groups. On top of this, these governments have been confronted with the large increases in rates of interest which have made it very difficult for them to issue securities to finance their needs for highways, schools, etc.

Unlike the business corporations, they cannot pass these higher costs on to anyone but the taxpayer. The large corporation, on the other hand, has plenty of cash normally and therefore is not very much troubled by higher rates; and often the consumer may be forced to absorb the costs of higher rates. Moreover, their position improves vis-a-vis their competitor's because of their more liquid financial position. This puts them at an advantage compared to the small business, for example.

Housing is another special area that is hit directly by the high money rate policy. From 1955 to 1957, residential starts dropped from 1,330,000 to 1,004,000 and expenditures from $20.1 billion to $17.2 billion. Other construction rose from $18.7 to $20 billion. These figures again suggest the uneven incidence of the general monetary policy. Higher money rates tended to reduce output where there was an excess capacity, for example, in the building industry.

Another area where general policies, like monetary policy, can do little good is in particular pockets of unemployment. In view of the large productivity gains in 1958 during the recession there was a great likelihood that these pockets would become very serious in the next year or two. Mr. Raskin, of the New York Times, had an interesting article on this matter recently. No monetary policy can really cope with this kind of a situation. For this reason, it is important that such areas as Detroit, New England (textile industry), Pennsylvania (coal industry), and similar areas should have the support of concrete programs to deal with these areas. They require, for example, planning, grants, loans to set up new industries, improved unemployment compensation, and the like. For this reason, I am hopeful that an area development program on an adequate scale will be introduced in the present Congress and receive the President's support.

*8. The recovery*

It is well to discuss monetary policy in relation to recovery. Indeed, there was a substantial increase of deposits and currency in 1958 and also in loans and investments. It will be recalled that the Federal Reserve was hesitant about increasing the member bank reserves and only brought about a reduction in the indebtedness of member banks. Of about $14 billion expansion of loans and investments of banks in 1958, the major factor was a rise of $10 billion in security holdings, mainly Federal, and a rise of $4 billion in loans. But business loans actually declined. Then how did the recovery come about?

No one has explained this more effectively than the President's Economic Report. In this report (p. 44), it is pointed out that from the third quarter of 1957 to the first quarter of 1958 an excess of receipts of the Federal Government of $3.4 billion was converted into an excess of expenditures of $6.6 billion. In other words, instead of draining the economy of cash, the Federal Government was increasing the cash resources of the economy. This is quite inconsistent with comments in other parts of the report about the need of a balanced budget and the like. Obviously, the deficit contributed greatly to the improvement in the situation. But the major factor here, as the President's Council admits, was the reduction of receipts. This decline was more or less automatic and the result of the very flexible tax system that has been inherited as a result of tax reform before World War II and during World War II.

These are, however, seasonally adjusted expenditures; and if one considers the actual contributions of the Federal Government, the results are not quite so satisfactory from the viewpoint of the Government's contribution. In the third quarter of 1957 to the second quarter of 1958, the gross national product declined by $17 billion. But Federal purchases of goods and services rose by only $1 billion, as compared to a rise of $3 billion for State and local governments.

Another very important factor in recovery was the large rise of transfer of payments from $21.6 billion in the third quarter of 1957 to $26.2 billion in the second quarter of 1958. These, of course, result from payments of unemployment compensation, old age insurance, and the like.

We should also mention the Federal bill for pay increase in part retroactive, a modest increase in wage rates in industry, the improvement in the agricultural situation as factors that tended to help bring about the recovery. On the whole, the contribution of Federal Government was small, except for the automatic response of transfer of payments and reduction of taxes. Had an actual tax reduction bill been achieved or a larger program of spending, the recovery would have been much quicker and probably would have saved billions of dollars. At any rate, the major factor in the recovery was not monetary policy. Perhaps we are asking too much of monetary policy.

9. *Recession, the threat of inflation, and Federal Reserve policy.*

In the third quarter of 1958, the Federal Reserve began to increase bank rates. Although unemployment was still above 7 percent seasonally adjusted, the Federal Reserve introduced once more a dear-money policy because it anticipated inflation. It should be noted that at this time, that is, in the third quarter of 1958, gross national product had increased by $10 billion as against a loss of $17 billion from the third quarter of 1957. But since an increase of $15 billion would be expected in 1 year as a normal rise or almost $20 billion with an allowance for the rise of prices, we can conclude that actually the recovery had only obtained about one-quarter of its potential when the Federal Reserve began to increase discount rates.

This policy is explained by a great fear of inflation on the part of the Federal Reserve. It seems to me that they tend to exaggerate the dangers of inflation. Perhaps the explanation is their concern that this is their special responsibility.

Time and again, and especially in the hearings before the Senate Finance Committee, the representatives of the Federal Reserve stressed the point that a creeping inflation would develop into a galloping inflation. More than anyone else, the Federal Reserve has made the country aware of the inflation danger. Yet, as I have indicated earlier, there is little basis for this projection. But the overall awareness of the dangers of inflation, to which the Federal Reserve has contributed so much, has had the result of inducing the leading financial men of the country to seek common stocks rather than fixed interest yielding bonds. The result in part has been a substantial rise in stock market prices which in turn has contributed toward the Federal Reserve's concern about inflation. Indeed excessive publicity given to the dangers of inflation tend to bring about the very condition which everyone wants to avoid.

For the same reason, I would not be inclined to support the widely proposed change in the law which would make it mandatory for the Federal Reserve to seek price stability. The proposed amendment, of course, goes beyond Federal Reserve policy. But the Federal Reserve has been in the forefront in supporting this proposal. If it is true that the Federal Reserve is excessively concerned over stability of prices as against maximum growth, this particular amendment would tend further to overemphasize this particular objective of economic policy. It is interesting in this connection that in the 1920's and the 1930's, when this proposal was made by congressional leaders, the Federal Reserve would have nothing to do with it. They claimed that they could not possibly stabilize prices. On the basis of past history, I am not sure they can do so now.

In this connection it should be noted that even inducing unemployment through dear money and restriction of the supply of money did not bring about a stability of prices—even with unemployment up to 7 percent.

This brings me to the issue of an independent Federal Reserve. I have never been very enthusiastic about an independent Federal Reserve. This is particularly true since the 1930's when the Government assumed a large responsibility for the economic well-being of the country. Independence has often meant that Federal Reserve can go any way it pleases, irrespective of the attitude of the rest of the country, or of other governmental agencies. This was, for example, made clear in 1956 in the midst of the dear-money policy. In the hearings of the

House Government Operations Committee under the Reuss bill, it was revealed that the theory of an independent Federal Reserve has contributed toward a failure to use fiscal policy. Here we have, of course, one of the great deficiencies of modern public policy in this country. Too much stress is put on monetary policy; and independence for the Federal Reserve results in an unwillingness to use fiscal policy and also results in independence for other agencies and therefore independence everywhere and no integration—or at least not enough integration.

This excessive concern with the stability of the price level, of course, means sacrificing those upon whom unemployment is concentrated as against a small loan to those with assets as against other gross gains for them. We should of course try to achieve the maximum degree of stability, but consistently with our other objectives.

As Congressman Reuss pointed out in the hearings on his bill, the President, impressed by the theory that the Federal Reserve should be independent, does not make recommendations on monetary policy. This is a most unusual situation. I carefully looked over the President's recommendations in the January 1959 report and found no suggestion by him concerning what Federal Reserve policy should be in 1959. Indeed, he discusses the responsibilities of labor and even of business and especially the governmental responsibility on fiscal policy. But not a word about what the Federal Reserve should do.

In his emphasis on the Federal budget, the President overstresses the significance of its contribution to inflation. In the table below, I point out that actually the rise of prices was at least as high in 1956–57 when the Federal receipts exceeded expenditures by $7 and $3 billion, as was the rise of prices in 1958 when expenditures exceeded receipts by $8 billion. Surely there is no evidence here of any very close relationship between the size of the Government deficit and consumer prices.

The inflation is much more to be associated with business policy. In 1955–57, the Government had surpluses. It was business that was spending more than its savings. It will be noted from the table below in successive years 1955–58 that business had to depend upon external sources for $18, $14, $13, and $6 billion. These large drains on outside funds in excess of their own funds contributed substantially to the expansion of the economy.

*Consumer prices and Federal receipts and expenditures*

| | Consumer prices (percentage plus) | Federal receipts and expenditures (billion dollars) |
|---|---|---|
| 1956 | 1.5 | +6.8 |
| 1957 | 3.5 | +2.9 |
| 1958 | 2.7 | −8.0 |

*Corporation expenditures and external sources*

[Billion dollars]

| | Expenditures | External sources |
|---|---|---|
| 1955 | 45.1 | 18.2 |
| 1956 | 39.9 | 13.6 |
| 1957 | 39.3 | 12.7 |
| 1958 | 33.5 | 6.0 |

It should also be noted that the Federal Government's net outflow on a cash basis in 1955 was $729 million, an inflow of $5,525 million in 1956 and a surplus of $1,194 million in 1957. This decline in the Government cash deficit, of course, would contribute toward inadequate spending, and therefore to the recession. Anotther factor, of course, was the reduced rise of consumer and mortgage debt, a reduction from $22.6 billion in 1955 to $18.1 billion in 1956 and to $14.3 billion in 1957.

Despite the restrictive policy of the Federal Reserve, prices continue to rise in 1956–58, though by the second half of 1958 the increase has been stopped. This continued increase in prices in the face of restraint is explained partly by the fact that with increased unemployment productivity declines. Though wage rates do not go up quite as much under unsatisfactory economic conditions as in boom conditions, and therefore to that extent prices tend to rise less, this is more than offset usually by the reduction of productivity in such periods of excess capacity. (Hultgren, of the National Bureau of Economic Research, in the hearings on the "Relation of Prices to Economic Stability and Growth," pp. 97–98, shows that in periods of unemployment prices tend to rise because of the concomitance of both wage increases and reduced productivity.)

The only alternative to rigid price stability is a substantial reduction of output, an increase of unemployment, and a concentration of the evils of economic distress upon a limited number. Why would not a solution lie in correcting the effects of a limited amount of instability? Those who are especially injured by the instability of prices, assuming a modest rise, are those who are dependent upon fixed incomes. Here the crucial issue is the position of those who live on fixed income and especially the old. Would not a kind of escalator clause under the old-age and survivors insurance very largely take care of this problem? It would certainly solve a good part of the difficulty of a moderate degree of instability of prices. Then we might have, say, an annual rise of prices of 1 or even possibly 2 percent, an average increase of output of 5 percent, and perhaps an expenditure of $150 million per year to cover a rise of prices of 2 percent for those who are especially injured by the increase, that is, the old. Even under private pensions, investment in equities tend to offset the losses resulting from inflation. The others more than make up for these losses through higher output, higher income, and more jobs.

### SUPPLEMENT ON QUESTIONS ADDRESSED TO CHAIRMAN MARTIN

Since writing the above, I have received the questions addressed to Chairman Martin. For the most part I have dealt with these questions. More specifically and briefly.

1. Proper division between tax policy and monetary policy as instruments of economic stabilization during the coming year?

The case for any restraint in 1959 is likely to be greater than in 1958, for the economy should continue to pick up. But even in 1959 the restraints are not likely to be needed. I would not support a policy which invalidates the wage bargains and Government fiscal policy by substantially increasing the amount of unemployment or by preventing a substantial decline of unemployment. If prices are stabilized as they were in the second half of 1958, then some easing would be justified. From the resulting increase of output, the amount of unemployment should be reduced. This is justifiable even if the cost has to be a price rise at an annual amount of 1 to 2 percent per year.

If prices should begin to rise at a rate, say, in excess of 2 percent a year, then mild restraint may be justified. But I would prefer an increase of taxes both to contend with any substantial inflationary pressure and to provide adequate funds for security and welfare without bringing about a substantial inflation.

2. Current policy of monetary authority?

Chairman Martin is the expert here. To me it seems too restrictive especially with prices stable and growth being contained.

3. The inflationary factors do not seem strong. A Government deficit is of some significance; but in the first half of the year, the large seasonal inflow of funds should substantially reduce its impetus; and in both halves of the year, improved conditions and larger yields of revenue should be a stabilizing force. The deficit for fiscal year 1959 is likely to be of the order of $6 billion rather than $12 billion as estimated in the mid-year budget review.

Private investment, a substantial factor in 1955–57, does not seem to be rising at a dangerous rate; and the rate of expansion of consumer and housing credit has been contained. An export surplus at the 1957 level is also not likely.

Too much publicity of the impending inflation contributes to inflation.

4. Really developed elsewhere.

5. Earlier easing in 1957?

I agree emphatically. Excessive concern over inflation seemed to concern the Federal Reserve. The Senate Banking and Currency Committee report (Aschinstein) showed that the Open Market Committee was not nearly so concerned over the inflation threat as Chairman Martin's statement. In fact by early 1957 the published minutes of the committee revealed increasing doubts of the continuance of the boom. Yet in August, Martin insisted inflation was the No. 1 problem. A lowering of rates did not come until November.

I do not believe, as some Reserve authorities seem to, that the "doubts about the dollar" are in any important sense a reflection of loss of confidence in the dollar. Are they not bringing reports back from abroad to this effect in order to gain support for restrictive policies? Actually our record on inflation is excellent compared to any other major country.

SUMMARY

*1. Threat of inflation is overdone*

So fearful is the Federal Reserve of a coming inflation that, in the midst of a recession with a recovery of only about one-quarter of the way to the expected peak and with 7 percent of unemployment, the Reserve raises discount rates in the third quarter of 1958.

And for a year of recession there was no increase of bank reserves to expand the total supply of money and no significant expansion in the excess reserves. In other words, the Federal Reserve has treated a future inflation when the real problem is to treat a recession.

*2. Anti-inflationary policy and the recession*

Its concern with inflation helped bring about a recession which in a period of 3 years has cost the country about $50 billion. This recession is in part the result of the restrictions on monetary supply, in part the result of the excess of capacity resulting from an investment boom. But the extent of the excess of capacity depends in part upon the supply of money which influences purchases, and buying was kept down by a vigorous Federal Reserve policy.

*3. What is the responsibility of the Federal Reserve?*

How far is the Federal Reserve supposed to go in voiding the decisions of the millions of employers and 70 million workers who make wage contracts? How far is the Federal Reserve supposed to go in neutralizing or restraining the Government in its fiscal policies? In other words, if the wage and pricing policies and governmental policies tend to bring about higher prices, how far should the Federal Reserve go in restraining these demands and therefore helping to bring on a recession? Undoubtedly, the Federal Reserve has some responsibility, but the question can honestly be raised whether they have not been assuming excessive responsibilities. To neutralize completely the expansionary effects of cost and price policy as well as governmental policy is a responsibility which the Federal Reserve cannot easily undertake and, moreover, is one not likely to be fulfilled.

*4. Cost push and inflation*

In the past, the Federal Reserve has generally tried to deal with inflation brought on by an excess of demand; that is, an excess of spending in relation to the flow of goods and services, with a resultant rise of prices. But more recently they have had to deal with the cost push.

By the cost push I do not mean merely increases of wage rates. In the last year or so many have exaggerated the contribution of wage contracts to the rise of prices. The Bureau of Labor Statistics has shown that the rise of nonwage costs are relatively as important as wage costs.

By trying to treat the cost push in the orthodox anti-inflationary manner the Federal Reserve helped bring on and strengthen the recession.

*5. Unemployment and prices*

Despite the rise of unemployment, prices continued to rise in 1956–58. In other words, we had neither stability nor high employment, though undoubtedly the Federal Reserve slowed the inflation.

Generally when unemployment develops, unit costs tend to rise; and, therefore, we get not only a rise of wages but an increase in cost due to the lower level of activity. Hence an unemployment policy contributes to inflation in that sense.

*6. Objectives of policy*

The objectives of economic policy are not merely stability, but also growth, equity, security, and the provision of necessary services. It is even conceivable that if defense needs are large and important, services like urban redevelopment are of great importance and are not being met, that an increase of governmental expenditures may be necessary even if this is contrary to the stability objective. Gains must be balanced against losses.

It may be said that the policy of the Government now seems to be to maintain stability of prices, even if it means a reduction of output increases to less than 2 percent a year, as against an attainable figure of 4 or 5 percent.

*7. Use of monetary policy*

In 1958 monetary policy as an antirecession policy was not adequate. The failure to get out of the recession more quickly was partly the result of excessive faith in monetary policy and yet with inadequate recourse to the monetary weapon, and therefore a failure to use fiscal policy, that is, a rise of spending and a reduction in taxes.

Actually from the third quarter of 1957 to the second quarter of 1958 Federal expenditures rose only by $1 billion as against a cut in GNP of $17 billion. A more potent fiscal policy would have brought about a recovery much sooner and cut the costs of the recession much below the $50 billion level. The year 1958 was the time for the tax cut, most likely not 1960, as the President implied. In 1960, in view of the need of services and the progressive improvement in the economy, the more likely policy would be a tax increase. Thus we would have the services without jeopardizing stability.

*8. Correcting for price instability*

Where the only alternative is, say, a price stability that is attained by a rise of unemployment by 2 or 3 million or more, or therefore at a cost per year of, say, $25 billion, would not a more sensible alternative be to have a rise of prices of 1 or 2 percent and a saving of these millions of unemployment?

Then in order to deal with this situation, those who are being hit by the inflation should be given special help. Most of the population would gain from full employment and the rising output as well as the increase in productivity. But those who are injured by the rising prices—and the most important group by far are the old who have to live on a fixed income—should be given special help. For example, an increase in the old-age and survivors insurance monthly benefit from $64 to $100 would only cost $3 billion a year in 20 years and perhaps $150 million additional to cover, say, a 2-percent inflation in the next year. This would be a much more effective approach than bringing on unemployment with its incidence heavily concentrated on 4 to 5 million unemployed. (Twice as many unemployed at some time in the year.)

*9. Legalizing the stability objective*

The Federal Reserve increasingly demands a requirement under the Employment Act of 1946 that stability of the currency be one of the fundamental objectives of economic policy. I oppose this particular proposal on the grounds that it would strengthen the hands of the Federal Reserve in their determination to achieve stability at the expense of other and frequently more important objectives. For the same reason, I am not in agreement that the Federal Reserve should be independent. So long as the Federal Government has serious responsibilities in the economic field, it is a great mistake to allow the Federal Reserve to be independent of other Federal policies.

*10. Failure to integrate monetary and other policies*

It has become clear that the Treasury does not issue long-term Government securities in periods of boom and thus help the Federal Reserve restrain inflation by absorbing excess cash, but issues long-term securities in the midst of recession, as in 1958, and therefore absorbs cash otherwise available to the economy, and delays the recovery. The governmental representatives before the Byrd committee insisted that it was necessary not to issue long-term securities in the boom because private borrowers wanted the money. This seems like foolish policy, that is, to favor the market at the expense of stability, and especially where stability is held to be the primary objective.

*11. Treatment of financial intermediaries*

The failure to control the financial intermediates makes it very difficult for the Federal Reserve to pursue adequate monetary policy. As the commercial banks are restrained, the financial intermediaries, that is, the insurance companies, savings banks, etc., more than fill the gap. They obtain inactive cash and make it active and therefore tend to increase the total amount of spending. A possible way to deal with financial intermediaries is to impose reserve requirements. Another approach is to control creation of their major assets, in particular, consumer and housing credit. But neither the Federal Reserve nor the Treasury, in thousands of pages of evidence, has ever made any suggestions on how to deal with this rather disturbing element in the money or the financial market.

*12. Is monetary policy a general policy?*

The defenders of monetary policy hold that it is to be defended because it is a general approach and does not interfere with the allocation of resources. Actually, a dear money policy hits especially schools, government generally, and small businesses against those business units and, in particular, large corporations that have plenty of cash. In other words, monetary policy is specific in its incidence. Nor does monetary policy deal with the difficulties of the depressed area.

*13. What has brought about recovery?*

Monetary policy contributed to some extent to recovery but not nearly enough. Indeed, debts to Reserve banks were reduced, and this was a stimulative factor. But much more should have been done to expand excess reserves.

The major contributions to the recovery have been first and foremost the automatic reduction of tax receipts and therefore the increase in deficit, with a reduction of income, a result of the changes of our tax structure that took place in the thirties and forties.

Second, there was during the crucial period a rise of transfer payments of about $5 billion, that is, increased unemployment, old age, etc., benefits. This important contribution to spending was the result primarily of social security legislation in the thirties.

Third, the increase in wage rates inclusive of the Federal increase of pay in 1958, part of which was retroactive, increased the spending stream.

Fourth, the increase in Government spending, which was slow in coming and insofar as it was effective was more largely the result of State and local, rather than of Federal, spending, was a factor. The recovery would have been more rapid had the Federal Government in 1958 been more aggressive in its tax and spending policies.

*14. Is inflation primarily caused by Government deficits?*

I have shown in my paper that this is not so, at least in peacetimes. There is no clear relationship between the extent of price increase and the amount of Government surplus or deficits from 1955 to 1958. But there is evidence that the rise of business spending in relation to business savings and of consumer spending in relation to consumer savings were important factors tending to bring about a rise of prices.

*15. In conclusion*

In boom periods, excessive recource to monetary policy accentuates the decline: In recessions, fear of impending inflation delays the recovery with losses of tens of billions to the economy. Stability is a worthy objective of policy, and we should seek to achieve it. But employment, growth, security, and sensible spending patterns are also worthy objectives.

Mr. Harris. Then, I will summarize it.

This is a fairly critical statement of Federal Reserve policy, but I do want to say at the outset, first, that I am speaking for myself and not for my university, and, second, though I am critical of recent monetary policy I want to say I admire Mr. Martin, Mr. Mills, and their colleagues for their courage and candor.

Now, about the objectives of monetary policy: I do not believe stability is the only objective of monetary policy as according to their actions the Federal Reserve System seems to believe. The administration, in general, has emphasized stability as the main objective and so has the Federal Reserve. In that sense, there is no independence for the Federal Reserve. It is part of the administration. Now, of course, these are matters of degree.

I think we would all be happy if we had a 10 percent rise of output and 1 percent rise of prices. But if we had a 10 percent rise in prices and 1 percent rise in output this would not be so good.

Now, if you will take a look at the table at the bottom—I am sure you had various versions of this table—I think you will agree the record over 10 years has not been too bad. The record from 1948 to 1952 was strikingly good with an increase in output of 5.5 as against a rise in the cost of living of 2.5. And in 1952–58 the record was not quite as good with a rise of GNP of 1.75 per year and cost of living of 1.5.

The CHAIRMAN. Dr. Harris, I do not want to dwell unduly on the time periods but apparently the record of 1948–52 was about three times as good as 1952 to 1958 in terms of gross national product.

Mr. HARRIS. That is right, Senator.

I even gave you a better statistic there, Senator, than that. If you look at the last column you have "Excess of percentage rise of GNP over rise in cost of living:" 120 for the 1948–52 period and only 17 percent in 1952 to 1958.

That is just another way of putting it. I think in all fairness it should be said, of course, 1948–52 covers the Korean war and that does make some difference. I think, allowing for that it is a better record than we had in the last few years.

I also want to repeat that the objective of economic policy is not merely stability. Again, growth, of course is important. Security may be much more important than stability and it is also important to have an equitable system. Sometimes it may even be desirable to sacrifice stability in order to achieve an adequate security program.

Now, is our system stable?

I am not so sure that our system is so bad. If you look at the history of the last 10 years and consider the average increase in the cost of living was only 2 percent, wholesale prices 1½ percent, and if you eliminate the Korean war, the figure would 1 percent and one-half of 1 percent, that is not a bad record; and it was accompanied by a rise of output of 35 percent.

The CHAIRMAN. The earlier figure is an annual figure?

Mr. HARRIS. That is right, Senator.

The CHAIRMAN. The second figure is an increase over the period.

Mr. HARRIS. Yes, the 35 percent is a 10-year period, or 3.5 per year; the rise in the cost of living eliminating the Korean war, was 1 percent and wholesale prices, one-half of 1 percent, again eliminating the Korean war.

That is not a bad record. I think we tend to exaggerate the depreciation of our currency. It is a good record compared to every major country in the world. I do not know any major country that has a better record, really.

Another point, I think we are all aware of is: We cannot be sure we have had 1 or 2 percent of inflation because there are certainly some doubts about index numbers, and I quote at the bottom of page 2 the Ruggles statement presented before your committee showing how you cannot take into account quality, really. I give you an example of that.

One of the major increases in the cost of living has been in medicine in recent years and one of the major factors here has been the cost of staying in a hospital per day, and that has gone up considerably, as we all know. But what is not allowed for in the index is the fact that it takes about half as many days to be cured as it used to. There is a clear case of improvement in quality that is not shown by your index number.

Now, about the treatment of inflation by the monetary authority, I think we are all aware there has been much more discussion recently of cost-push against the excess demand. I am not quite sure the Federal Reserve is quite clear on this issue. They try to deal with the cost-push inflation the same way they deal with the excess demand inflation.

In general, the emphasis on the part of the administration has been, I think, as a general rule, that labor is largely responsible for the inflation.

Now, there is no doubt but that labor has made a contribution. I think it is also clear that there have been other contributions and I think labor has been blamed excessively. Against the increase in wage rates we should consider the rise of productivity.

If you look at page 4 presented by the Bureau of Labor Statistics, and you may have had this at some time or other, you will notice an increase in salaries and wages per dollar of real product (1947 equals 100) of 31 percent by 1957. An increase of nonlabor costs was 30 percent, suggesting that the contributions of the nonlabor elements in our society were just as large as the contributions of labor per dollar of real product.

Now, if you look at the next line you find that average hourly wages and salaries rose by 67 percent and that suggests an increase that is substantially larger than that in output and this, of course, is the inflationary aspect of the rise of wages.

You notice that the real product per man-hour in the private sector went up by 37 percent, which is roughly about what wages and salaries went up per dollar of real product. The difference is not really large.

An interesting piece from Miss Mack of the National Bureau of Economic Research shows that spot market prices fell by 10 percent of their 1947–49 average, crude materials rose by 16 percent and all manufactured goods rose by 34 percent.

Labor cost does not explain these divergent trends. Between 1947 and 1957, according to the indexes prepared by the staff of this committee, labor cost increased about 15 percent of its 1947–49 average.

In other words, the cost of labor and the cost of crude materials rose at about the same rate and both rose substantially less than did the prices of manufactured goods.

What then is the explanation of the divergent trends? It does not lie primarily, of course, in bulging profits. Rather, it must be found in the increasing amounts of fabrication to which materials are submitted, increased marketing costs, increased administrative costs, costs of research, of insurance, of development. These shifts in products and in cost structure thrive in the general atmosphere of the times. Many of the emphasized costs are of the overhead or burden type. There is a widespread belief that the strong upward trend in demand is truly durable. This weakens usual fears of saddling a business with heavy overhead—type costs.

May I just read the next page as I think it is rather important.

Perhaps the crucial point is, in the face of these cost pushes, whether is is the responsibility of the Federal Reserve to offset these by restrictive monetary policies and thus bring on unemployment. This is what clearly occurred in 1956–57. Is it also the responsibility of the Federal Reserve to neutralize the effects of governmental policy? If the inflationary pressures are brought on by wage contracts which are made by 70 million workers and a few million employers and also by the needs of Government, is it the responsibility of the Federal Reserve to interfere with these movements in order to achieve absolute price stability? Obviously, the Federal Reserve has some responsibility for restraint, but the real question is how far?

In our economic society it is almost impossible to bring about a reduction in wage rates. Therefore, as a minimum we can assume a stable wage rate in the less effective or less productive or lesser growing industries. In the others, there are bound to be differentials, that is, some wages must rise more than others in order to bring about the proper allocations of labor and other resources.

Even in 1958, despite the fact that many labor leaders, like Mr. Reuther, showed great restraint in view of the recession the UAW obtained wage concessions from the manufacturers. We may, therefore, assume rising wage rates even in recession. If they are offset by increased productivity or absorption by capital, then we should have no inflation. If they go beyond that point, then the Federal Reserve has to face up to the problem of whether it is prepared to cut output, say, by $50 billion in a few years and reduce the average output by a few percent a year over the years in order to bring about absolute stability.

Not only is this a serious responsibility for the Federal Reserve, but also reflects one of the great difficulties the Federal Reserve has in achieving stability.

Now, on the control of money and spending: I think in a general way the Federal Reserve has tried to reduce the supply of money and in reducing the supply of money has hoped to bring about an increase in savings and higher interest rates. But unfortunately a reduction in the supply of money and higher interest rates also cuts investment. And so from the third quarter of 1957 and the second quarter of 1958 we had a $17 billion cut in investment.

The Federal Reserve also soon discovered that cutting the supply of money could not do the job of containing inflation, because bank debits rose by a great deal. In one year there was an increase of 1 percent in supply of money, an increase of 8 percent in banking debits.

The Federal Reserve was so sure of its position that at one point Chairman Martin before the Senate Finance Committee said they could even control the velocity of money.

> We have let the balance of the 2 percent on our 3 percent growth take place out of the velocity of money, the turnover of money, and we have felt that this was about right, though I think sometimes we felt that perhaps we have erred a bit on the side of letting velocity accumulate faster—it is very difficult to measure—than the situation warranted.

Another difficulty the Federal Reserve runs up against is the problem of the financial intermediaries, the banks, insurance companies, savings banks, loan societies, pension funds, Government credit agencies. These agencies tend to reduce the powers of the Federal Reserve.

And it is an interesting thing that in one of the discussions Secretary Burgess said that the expansion of financial intermediaries, while the Federal Reserve was trying to cut down the total supply of money, was all right because this came out of savings.

It is also an interesting thing that while the Federal Reserve was trying to cut supplies of money on several occasions since 1952, Government credit agencies kept on expanding their total assets throughout this whole period.

It is also an interesting point that over a period of 6 years while there has been a tremendous expansion of the contribution of intermediaries the Federal Reserve has never once nor has the Treasury suggested any way of dealing with these financial intermediaries and I think it might be very worthwhile asking the Federal Reserve why this is so.

Now, actually of course we all know that financial intermediaries can bring about a great expansion in face of contraction policy on the part of the Federal Reserve. It does happen. But in any case what really happens is that the financial intermediaries attract cash from the public, relatively inactive cash, and make it active, and this, of course, tends to increase the total amount of the expansion. This is part of the general problem of liquidity, that the economy's liquidity makes it more difficult for the Federal to control.

In 1955, as the Federal Reserve admitted, they tended to be expansionists, increased the reserves of member banks, which, in turn, bought large quantities of Government securities. Then later when the Federal Reserve tried to restrain the market, these securities were sold, with the result on the price of Government securities.

I sense that on the whole the Federal Reserve still is not sufficiently aware of the modern advances of monetary theory, which put much more emphasis on total amount of spending as a factor in inflation than the total supply of money.

I need only briefly say here that the Federal Reserve is determined to do a job and yet makes its own position much more difficult by self-imposed limitations; and of course the most obvious one is the "bills only" doctrine. The defense of the "bills only" doctrine, as far as I can gather, although there are several, one of the major ones is the Federal Reserve must not interfere with the function of the securities market by introducing an element of uncertainty. Therefore it will not buy Government securities, long term Government securities.

Of course, this is really a statement to the effect that stability is not important even though this seems to be the major objective of the Federal Reserve, because of the fear of introducing uncertainty into the market.

Another limitation the Federal Reserve puts upon itself is that it does not concentrate as was true years ago and has always been true—it does not concentrate on the reserves of member banks.

And now what the Federal Reserve tells us is not that they have expanded the reserves of member banks upon which member banks increase their purchases of assets, but they tell us they have given the member banks more free reserves. By that they simply mean that they take the total excess reserves and deduct from the excess reserves any indebtedness to the Federal Reserve. This was a theory that is the restraining effect of banks being in debt that was developed in the twenties and the Federal Reserve found they could not control the reserves of member banks; but I have never been impressed that this is not nearly as important a matter of business, being in debt to the Federal Reserve, as the Federal Reserve claims it is.

In any event, it is an interesting point. Throughout 1 year of recession there was no net increase in either reserves of member banks or in excess reserves and a slight increase in excess reserves. This is an unusual monetary policy for a central bank. I think even in the early 1930's when we knew less about these problems a much better job was done in containing a recession.

Now the problems of——

The CHAIRMAN. Dr. Harris, may I interrupt for a minute?

Mr. HARRIS. Yes.

The CHAIRMAN. Congressman Patman brought out a very significant point in cross examination of Chairman Martin this morning. He pointed out that the member banks have increased their holdings of Government securities by about $10 billion. So the added lending power of the banks was absorbed not so much through lowering reserves, and was absorbed hardly at all in loans to business, but rather in the purchase of short time governments. Is that true?

Mr. HARRIS. That is absolutely right. Congressman Patman is right.

As a matter of fact, I have a few sentences in the paper somewhere exactly to the same effect. The situation was used primarily to buy Government securities and not to make loans to business. In fact, the Federal Reserve tries to defend this on the grounds that since the inventories are going down, and so forth, you would not expect any great increase in loans.

Now, the problems of integration: You may recall in 1953 the Treasury led the movement toward dear money and the Federal Reserve acquiesced.

In 1956–57 we have been told by almost all economists that this was a period of restraint and according to the theory of restraint if you are really trying to restrain the economy, what the Treasury does is not to sell short-term securities but to sell long-term securities. Actually of course they sold short-term securities in 1957–58.

When Secretary Burgess was asked about this a year ago he explained it simply by saying—

Well, you know, the market wanted all the available cash and we couldn't really compete with the market. We thought the market had first choice.

Now, that is a rather dubious theory because after all, the Government has some important responsibilities in our economy as well and if you are interested after all in stability, one way of getting stability is to issue long-term securities and absorb the cash as a result. But perhaps the major error I would say was incurred in the first half of 1958, when according to the President's Council report, and I quote January 1959, page 44:

In the first 6 months of the year $19.6 billion intermediate and long-term securities were issued, which resulted in a significant increase in the average length of the outstanding marketable debt.

Here is a central banking system that is trying to get out of a recession. They manufacture more money. And where does the money go? It goes to buy the long-term securities that the Federal Government is issuing.

Well, as a matter of fact, according to all accepted theory they should have been issuing short-term securities. It is no wonder we had this very high interest rate in 1958.

Along the same lines, just to indicate the lack of integration that we have at the present time, the Federal Reserve proudly announced in November 1957 that they had reduced their discount rates from 3½ to 3 percent and the Council says: "Signaling a decisive change in policy."

It is awfully interesting that 3 or 4 months earlier the Housing Administration had introduced policies which indicated a decisive change in policy.

It is always interesting, as was pointed out by the Senate Banking Committee's report on recent policy, that in January 1957 the Open Market Committee had already indicated that they were very dubious that there was going to be further increase in business activity. This, itself, would suggest anything but a continued policy of restraint.

Now, one can go even further. The President expresses great concern over inflation, the need of Federal Government showing great restraint and leadership—One can go even further and point out the President's great concern over inflation and the need of the Federal Government showing great restraint and leadership. The Federal Reserve fearing an inflation had already increased its discount rate in the summer of 1958. The Federal outlays for 1959–60 were to be reduced by $3 billion and the budget to be balanced.

But contrast the volume of Federal loans and guarantees and we find an entirely different philosophy. The Federal credit agencies have increased their loans since 1953 from $19 to close to $28 billion.

But the most startling increase is of guarantees from $31 to $69 billion. And even in fiscal year 1960 it is anticipated that loans will rise by only $1 billion but at the same time the budget announces that there is to be an increase of $9 billion of guarantees, a tremendous increase.

If you go back to 1953, what do you find? An increase of loans from $19 to $28 billion. That is a $9 billion increase in loans by Government credit agencies and an increase of guarantees from $31 to $69 billion. That is an increase of $38 billion and $9 billion in 1 year, this comes in a year when there is such great concern at the White House about inflation.

Now why this tremendous increase in guarantees because after all these also increase spending, and increase the use of credit resources.

Well, of course the explanation is obvious. Guarantees do not count as expenditures in the budget, therefore, you issue them in large quantities without raising budgetory outlays.

But note again this is a failure to integrate the policies of the Federal Reserve and the policies of the credit agencies as well as the Treasury.

Now, on page 10, the new section, failures of monetary policy: I think the best indication of failure of monetary policy is to say in 1958 we had a rise of 8 percent in prices and no increase in gross national product. Going into a little bit more detail what we can say is, and even assuming only a 4 percent rate of growth, that we failed in 1955 to achieve our goal by $4 billion, in 1957 by $14 billion and in 1958 by $30 billion, or you can say the monetary policy contributed to a loss of $38 billion in all.

This policy failed because not only was inflation not stopped but recession followed.

Indeed, the Federal Reserve probably contribluted to a slowing up to the price rise, but also to the recession. I do not mean to put the recession entirely at the doors of the Federal Reserve. There clearly was an investment boom in 1955, but one must not forget "excess capacity" is a relative term.

Mr. Martin I think said this morning that prosperity depends not only upon supply but upon demand.

The Economic Council has a chart showing that capacity increased by one-fourth in 1953 to 1957 and production increased by only 7 percent; hence the rise of excess capacity; but excess capacity is relative. It is relative to the amount of demand and the amount of demand depends in part on the supply of money. If you cut down the supply of money you obviously increase the excess capacity. Excess capacity as used by the President's Council seems dubious to me. It is based largely, I think, on the McGraw-Hill estimates of capital building and so forth but actually, of course, we all know that capacity depends upon cost. You can always increase capacity more if you are ready to pay for it with higher unit costs, and capacity also depends upon demand. There is no absolute capacity.

Now, monetary policy is generally defended as a general approach and it has the advantage, therefore, of being in support of market conditions. You allow the market to determine what is going to happen. But actually is it really a general approach?

In its incidence it is highly selective in its effects. Consider, for example, the Federal securities markets. I agree with Senator Douglas as I know his position that there was a great deal to be said for the accord of 1951. The Truman administration and perhaps the earlier administration had excessively tailored its monetary policy in order to support the Government bond market. This probably went too far.

Money policy should be determined in terms of the interest of the whole Nation, not merely the Government bond market. But one could say just as well in recent years we introduced a monetary policy that says, "Disregard the Government security market." The net result, therefore, was despite the fact that Chairman Martin said earlier that he was not worried about the effects of a high money rate policy on the security market, because with a high money rate policy banks are not going to dump Government securities. If they do they will take a beating—they will suffer losses if they dump Government securities.

Well, actually, from 1954 to 1957 the financial institutions disposed of $19 billion of Government securities, despite Mr. Martin's anticipations.

Another indication of how nongeneral the monetary policy is in its effects is to consider State and local governments. Here you have governments which have increased their expenditures, increased them by 2 times in 10 years, and they have increased their debt from about $15 billion to $50 billion. They are having a tough time borrowing as much as $4 billion a year. They are up against serious difficulties in the market.

In the first place, because it is so much easier to avoid taxes than it used to be, the appeal of the tax-exempt security is not nearly as great as it used to be. That is one factor in the situation.

Another factor is, of course, so many of these securities have been issued and also competing securities, that in order to sell them you have to appeal to people with lower incomes for whom the tax exempt feature is of less use and less value than previously.

In that kind of a situation you add the liability of higher interest rate, and this makes it very difficult for these State and local governments to raise the money that they need for schools and highways and other items of that kind; and one must not forget that State and local governments cannot pass these higher costs on to the consumer. They can only pass them on to the taxpayer.

Large corporations, on the other hand, generally have plenty of cash available and they are not very much troubled by higher rates. In fact, their competitive position may be improved and often the consumer may be forced to absorb the cost of higher rates of the corporation.

Another indication of the special effect of higher rates is what has happened to housing. Housing starts dropped severely from 1955 to 1957, though housing expenditures did not decline as much. But it is interesting in this period when housing expenditures fell from $20 billion to $17 billion, the expenditures on nonhousing construction actually rose, showing again the discriminatory effects of a higher monetary rate policy. You hit the little fellow building a house but do not hit the major construction projects.

Finally, I know Senator Douglas will approve, but I am very sincere because I myself have testified on the Douglas bill area development. The problem of dealing with special aspects of the economy is a difficult one. You cannot deal with this kind of a problem through monetary policy. If you raise your rates and you bring about unemployment then you accentuate these pockets of unemployment. Perhaps you have seen Mr. Raskin's article in the New York Times recently that suggests something that is very clear to me up in New England, namely, that partly as a result of the increased unemployment and obviously your most vulnerable areas in industry feel this first, and partly because of the general effects of the dear-money policy, what follows on increased pockets of unemployment that cannot be treated very effectively by easy-money policy though this may make a contribution; and the only way of dealing with this kind of problem is direct action through planning, grants, loans, et cetera. And I hope very much that the administration will support a really vigorous bill in this area to offset to some extent the adverse effects of unwise monetary and fiscal policy.

The CHAIRMAN. Thank you for those kind words. Such a bill has been introduced in the Senate with 40 sponsors and there are a large number of individual bills in the House.

Congressman Patman gave yeomen service getting the bill through the House's Banking and Currency Committee last year, and we have hopes that we may get such a vote again and that the gentleman down at the White House does not veto it.

Mr. HARRIS. I am pleased to hear that. If you need any help from me, let me know. Are you going to have hearings, Senator, on this?

The CHAIRMAN. Yes.

Representative PATMAN. May I comment?

The CHAIRMAN. Yes.

Representative PATMAN. If these distressed areas were in any other country of the world, outside of the Iron Curtain countries, we have five agencies supported by U.S. Government money that would come to their and and rescue them immediately; but here in the United States there is no place to turn.

Mr. HARRIS. There are just three or four, the coal area, the textile area, the automobile area.

And one of the interesting things that happened, as you all know, in the last year, in response to the recession there was a considerable amount of rationalization and reduction of the unit costs, with increased productivity. This has cut down demand for labor and this makes the situation so much more serious; and this, I think, does not make the problem of the Federal Reserve a much more difficult one, because they can show improvement in many other areas but, on the other hand, when they look at unemployment they are really in a tough spot.

Now, the recovery:

I think on the whole if you notice, Congressman Patman, there is the point you raised of the $14 billion expansion of loans, and so forth.

Now, no one has more effectively explained what got us out of the recession, I think innocently, I might say, than the President's Economic Report, page 44. It is pointed out that from the third quarter of 1957 to the first quarter of 1958 an excess of receipts of the Federal Government of $3.4 billion was converted into an excess of expenditures of $6.6 billion.

In other words, instead of draining the economy of cash, the Federal Government was increasing the cash resources of the economy.

As a matter of fact, this is quite inconsistent with the general balanced-budget approach in the report, and these figures are, in a sense, misleading because they are seasonally adjusted and, therefore, do not really tell you what actually happened.

I heard a great deal said about how the administration pulled us out of this recession. I do not want to deprive the administration of its contribution. They certainly made some contribution. I want to be fair about this even though I have Democratic prejudices. But it is also true, nevertheless, that if you go from the third quarter of 1957 to the second quarter of 1958 what you find is a reduction of investment of $17 billion and an increase of Government purchases of goods and services of but $1 billion. That is hardly an adequate offset for a recession that has been going on for quite a while. State and local governments, in much more serious financial shape, however, contributed $3 billion of increased purchases of goods and services.

What pulled us out of the recession?

Let me just say I think the most important contribution was the reduction of tax receipts that came automatically because we had a flexible tax system that was introduced in the 1930's and during the war. This is a great help.

I myself believe we should have had a tax cut as well, a change in the structure and if we had we would have been out of the recession much sooner; though I give the administration some credit for the improvement, I think the improvement could have been greatly accelerated by a real tax cut.

In this I find myself in agreement with the CED and the chamber of commerce. I do not often find myself in agreement with the latter but I did this time.

Another very important contribution was the increase of transfer payments from $21.6 billion in the third quarter of 1957 to $26.2 billion in the second quarter of 1958. This again is the result of the social security program primarily that was introduced in the 1930's.

It shows, as a result of reforms that were made we now have a much more flexible system of what the economists call built-in flexibility.

There are a few other items that contributed to the recovery. For example, the rise of wages increased purchasing power and therefore made it easier to get the necessary spending when we needed it badly. The same thing goes for some increase in the agricultural income. Monetary policy made a contribution but not as much as it might have.

Now, I want to point out that it is a rather unusual economic policy when in the third quarter of 1958, with unemployment at 7 percent and with a recovery which I estimated only one-fourth of its potential, because, as I argue here, the gross national product had increased by $10 billion as against a loss of $17 billion in the third quarter of 1957, and given the rise of prices, we should have had a rise of GNP of $20 billion.

So against the losses of $17 we had a recovery of $10 billion and that was a signal despite the 7 percent of unemployment for the Federal Reserve to introduce a dear money policy.

Now, I think that the Federal Reserve has a great fear of inflation. I think this fear is exaggerated on the basis of our history. I heard Chairman Martin make some comments this morning about how serious this problem was. It is interesting in the last 10 years our inflation has only been one-third of the British inflation and the British are really far from experiencing an out-and-out inflation. The general idea that creeping inflation inevitably results in galloping inflation is a theory I do not accept and our own history does not prove it.

I would also like to point out, and I gather this issue has been raised before, that we were all very much struck by the fact this year of 1958 that a great many people dumped their bonds and bought stock market equities. This worried the Federal Reserve a good deal and they took this as a signal of an inflationary neurosis in the country.

Now, there are all kinds of explanations, I do not want to blame the Federal Reserve for this neuroses. But I do think if you go over the country and tell everybody we are in a great inflationary danger and when one considers the prestige that Mr. Martin has in the financial groups, and one considers that the financial groups are people that determine investment policy, a relatively small number of people, well organized, knowing one another, through investment trusts, and other funds of that kind, I do think if you worry too much about inflation, if in the midst of every period of prosperity you are always thinking of the inflation and the next recession that will result from the inflation, I think this does tend to some extent to introduce an element of consciousness of inflation that is greater than is justified by the underlying events.

This brings me to the question of whether we should go along with the Federal Reserve and give them the right or the authority or even demand of them that they stabilize the currency.

In this connection, having been a historian of the Federal Reserve, I know well this idea was broached many times in the twenties and thirties and each time the Federal Reserve said, "We do not want it. You are asking us to do something we cannot do." Why this sudden change? I may be wrong but I detected from Mr. Martin this morning that perhaps he is having a little doubt about this again. He did not seem to be nearly as much for it as he was a year ago. There has been a strong campaign to introduce this particular objective in the Employment Act of 1946. Now, I myself think it would be a mistake, and in the first place, I am sure the person cannot stabilize, and hence failure would be embarrassing to him. I think I am trying to save them some trouble later on.

In the second place, I am not at all sure we ought to do it even if they could do it, or try to do it, because I think they are excessively oriented toward stability as against all of the other objectives of economic life. Despite what Mr. Martin said this morning—and I gather a greater tendency to emphasize growth and other objectives in the statements issued from the Federal Reserve—I believe this is largely a proper objective.

But on the basis of history I say it would be a great mistake to give the Federal Reserve the orders to stabilize our currency because this is an organization that tends to overemphasize this objective as against other objectives anyway.

Now, it is interesting, of course, that the last episode when we had, as I said before, an 8-percent rise in prices in 3 years and a good deal of unemployment does not suggest tremendous success.

I notice Congressman Reuss here, and I remember testifying before the Government Operations Committee for a bill that he introduced in which he raised some issues about just exactly what is the authority of the Federal Reserve and what is the relationship between the Federal Reserve and the rest of the Government.

Now, I myself perhaps am heretical here. I do not myself believe in the independent theory of the Federal Reserve. This was all right in the 1920's when after all the Federal Reserve did not have a very big job to do and when they did have a big job they messed it up pretty badly, as we all know. I think they tried to do a better job in the early thirties actually, than they did in the twenties, but I think it is important to point out that, in the first place, as Congressman Reuss pointed out, the President feels it is incumber upon him to say nothing about monetary policy.

Is this not a ridiculous situation? If you are trying to stabilize your economy, you are trying to increase the output of your economy, whatever you are trying to do, you use all your weapons.

Do you allow one organization to go one way as happened so many times recently, and all the other organizations go another way? Do you have an independent Federal Reserve? If you do are you not going to have an independent Treasury, and independent Government credit agencies and so forth?

And following Congressman Reuss' lead, I looked at the 1959 Report of the President to find what the President said about monetary policy, what should be policy in 1959 and not a word, and so I myself think that if the Government is terribly important in the determination of our economic growth and stability and what not, that the Federal Reserve should inegrate its policies with other agencies of the Government and they should work together and the Federal Reserve should not demand independence. As a matter of fact, its failure to integrate its policies with other agencies despite its independence I think on the whole has been costly to the economy rather than the reverse.

And if you concentrate excessively on stability what do you do to the economy? You concentrate the disease of the economy on a relatively small number of people. These are the people who are unemployed. You make them suffer severely and for every man who is unemployed at one time in any one year you have two people unemployed, say for the 5 million people you have unemployed now, you have 10 million people unemployed in the year and many other millions terribly worried about the possibility of being unemployed.

Should we encourage a monetary policy which aims at fairly rigid price stability and concentrates the cost of their policy upon a relatively small number?

Now, if the administration were at least willing to do a really good job for this group of unemployed, which they were not ready to do last year then I would say I would not feel quite so badly about it. They did not give us an adequate compensation bill and they killed the area development program.

I would suggest another approach to this problem. I would say try awfully hard. It is important to stabilize. But do not accept this as your only objective. If you get off base a bit and you have some trouble and prices rise 1 or 2 percent a year who is really hit? The people who are hit particularly are the old people. And there is a way of dealing with this problem. As a matter of fact, if you had a 2 percent inflation it would cost only $150 million or $200 million a year more to offset that in the old age and survivors insurance program and this would be a small cost compared with the cost of a recession.

In my own field, for example, there has been an awful lot of talk about how teachers are underpaid. I think teachers in colleges are underpaid partly because the college administrators are not always as effective as they might be. They could easily adjust their tuition to the inflation and pay the teachers an adequate salary. Most of the population gains from growth accompanied by a small amount of inflation. So they do not have to be reimbursed but the old people with fixed incomes do.

And it is an easy problem to deal with this, and in the private pension funds, as you probably know, a large part of the total reserves go into equities. And this to some extent offers a considerable amount of protection.

I am rather sorry that the President emphasized as much as he did the great contribution of deficits to the inflation.

May I point out to you this table? If you can see any correlation there between the Federal deficits and the rise of prices you see something there that I do not see, because there is absolutely no evidence in these 3 years that there is any close correlation between deficits and the rise of prices. I would say there is a much closer correlation in another field, that is, if you compare, for example, the total expenditures of the consumers, rather, or business, and the amount of savings that business does.

If you look at 1955 in the bottom table you see that business was spending privately for investment $45 billion, but they obtained $18 billion from external sources. In other words, they were spending much more than they were saving on their own. This is an inflation factor given by itself. In 1956 it was $40 billion and $13 billion, and in 1957 it was $39 billion and $13 billion, but by 1958 that inflationary factor had been reduced.

Let me also point out a thing that I am sure particularly Senator Douglas knows so much better than I do because he worked in this field so much.

If you bring on a recession you tend to bring about a double cause of inflation because as we all know these days wages rise in a recession or in prosperity. They rise somewhat less in recession, as you can see, even in the fifties but on top of that you bring about a reduction of man-hour output because you are producing much below capacity. That tends to bring about a rise of prices. Therefore, you tend to have a double factor that brings about inflation; the continued rise of wages and the reduction of productivity.

This has all been shown by a study of the National Bureau of Economic Research by Hultgren, and in fact parts of it are published in your last volume on the relation of prices and economic stability and growth.

So much for my statement.

I received the questions addressed to Mr. Martin after this was written and I just hurriedly put together just a few items here in an attempt to try to answer Mr. Martin's questions.

The first question: The proper division between tax policy and monetary policy as instruments of economic stabilization during the coming year?

I must say I think this was made clear in Congressman Reuss' bill that this excessive emphasis on monetary policy does mean that you tend to neglect fiscal policy. If you depend too much on monetary policy you tend to neglect fiscal policy. For example, if we should have a rise of prices of 2 percent or more in 1959 at that rate then we may begin to worry about some restraint. We certainly have no justification for restraining when prices did not rise at all in the second half of 1958. If they rise by 2 percent or more I would be inclined to depend on a rise in taxes and a moderate degree of monetary restraint.

Now, the next question is: The current policy of monetary authority?

My answer here is that Chairman Martin is the expert here, though it seems too restrictive, especially with prices stable and growth being contained.

The third question: Are the inflationary factors strong?

I do not believe they are myself. I do not think there are signs of any very large investment boom. I think the budget situation is not so bad. I am surprised the Federal Government has said—as far as I know has said—nothing about the current trends in the 1959 budget.

I cannot believe, having started off with a balanced budget in January 1959 and announced a $12 billion deficit by July or August 1959, why they have not changed the estimates for the fiscal year 1959? I cannot believe that they still believe there is a $12 billion deficit. If they have not announced a change I think what they are trying to do is to keep the budget down because if you say the deficits are going to be $6 billion, $7 billion, or $8 billion, people will say, "Let us do some of the things we really ought to do." It is conceivable. I have not seen your hearings. It is conceivable perhaps, the Secretary did say something about this. I am rather surprised we had nothing on this particular point.

One must not forget that in the first half of the year incomes tend to be large which tends to offset deficit trends in the budget. In the second half you are going to have continued growth, undoubtedly. This undoubtedly would be another factor that would tend to keep deficits down.

I hope this committee—if they have not needled the Secretary on this, I hope they will.

That is my answer to question No. 3.

Question No. 4 was developed elsewhere.

Question No. 5: "Earlier easing in 1957?" I agree emphatically that the easing should have come much sooner. I say something about what the Open Market Committee said in early 1957. I point out other agencies operate in this way and I believe the failure to take action much sooner reflects again Mr. Martin's position that he is always worrying about the next recession, itself tied to the present inflation, which he sees and many other people do not see.

I would like to make one personal remark because I heard Mr. Martin say this morning that these people who think inflation is inevitable—such a statement was put in Life and the statement in Life said that many smart people are talking as though inflation is inevitable. This even includes some professors at Harvard. I do not know whom they have in mind. Probably Schlicter or Harris. I asked Schlicter, "Do you believe inflation is inevitable?" He said, "Of course, I don't."

I said, "I certainly agree with that position."

I think all we are saying is it is not easy to stabilize the price level the way the Federal Reserve does or tries to do without risking a great deal of unemployment. You have to weigh one against the other. This does not mean you are saying that inflation is inevitable as Mr. Martin said some people say.

Mr. Chairman, I have a summary here that I could read. I do not know if you want to listen to five pages of reading. Let me just see if there is anything in here that I have not already covered.

What is the responsibility of the Federal Reserve?

Here again I tried to point out that I just wondered if their job is to invalidate the decision of all the workers and Government and how far should they go.

Under 4 I simply say that the cost-push is something different than the increase in demand.

Under 6 I summarize the objectives of policy about which I have said a good deal.

Under 7 I point out in part the monetary policy is responsible for the $50 billion loss.

Under 8 I again wonder how you weigh the loss of income as against an improved stability of prices of perhaps 1 percent or thereabouts.

Under 9 I again say there is a great mistake to legalize the stability objective.

I do say one thing that I have not said in the paper here.

How can you deal with these financial intermediaries? How can you really deal with this problem?

I have thought about this a good deal and it is not easy to come up with an answer. I think I have a few possible answers.

One is you might conceivably control consumer credit and housing credit. This would control the financial intermediaries. These are the kinds of assets they buy. Another possibility is to put them under the same restriction that the commercial banks are subject to, for example, reserves. I am sure other people can think of other approaches, but I do think it is terribly important because these financial intermediaries have become to important. It is an entirely different situation than we had when we set up the Federal Reserve System. It is very important that we should think of some ways of handling the financial intermediaries. If you do not, the Federal Reserve is going to be innocuous.

Mr. Martin said in his statement, "Yes, expansion of money occurred, a great contribution in 1958."

"Not only did we make this contribution," he said, "but all these other agencies began to expand their credit." But he does not say in 1956–57 when he was restricting, all these other agencies were expanding. And this ought to be brought to his attention.

Then under 13 I again summarize what brought about the recovery.

And is inflation primarily caused by Government deficits? The answer is "No."

No. 15, in conclusion.

In boom periods, excessive recourse to monetary policy accentuates the decline; in recessions, fear of impending inflation delays the recovery, with losses of tens of billions to the economy. Stability is a worthy objective of policy, and we should seek to achieve it. But employment, growth, security, and sensible spending patterns are also worthy objectives.

Senator Douglas, I listened to and read this statement of Chairman Martin. I only arrived here about 11:30 because there was a delay on the train, but I read Mr. Martin's paper, and I do have a few comments I could make on what he said this morning, if you would like to have them.

The CHAIRMAN. Yes, sir.

Mr. HARRIS. I will just take about 5 minutes. Some of the points I have made here. But there were a few points I think perhaps where he was getting away with something.

If you have that statement. I do not know if you have that statement there. Do you?

The CHAIRMAN. Yes.

Mr. HARRIS. He says:

As reported oi you last year, Federal Reserve policy began to shift in a counterrecession direction in late October and early November of 1957.

Everybody agrees that was pretty late, and I would not boast about that.

The CHAIRMAN. You will remember that I questioned him this morning, as I have in times past, whether it was correct to raise the rediscount rate in August.

Mr. HARRIS. Yes.

The CHAIRMAN. And you heard him again defend that.

Mr. HARRIS. I am not convinced myself it was not a mistake. I am convinced it was a mistake to raise it in August and a great many other people believe that, too.

He says, and I think this is a rather misleading statement—I do not mean to say he is trying to mislead anybody, but I say it could mislead the reader. He says near the bottom:

> Through continuing open market operations from late fall of 1957 to early last summer the Reserve System supplied the commercial banks with some $2 billion of reserve funds.

That is nonsense because they never provided $2 billion of reserve funds. What they did was they offset to some extent the exportation of gold. What you really get from November to April is a reduction of reserve requirements of $700 million. You get an increase of excess reserves of $100 million, and your debts are reduced, that is, commercial bank debits reduced by $800 million. That is considerably different than what Mr. Martin says on that statement.

And to some extent he says something different on the next page. How you can reconcile these two I do not know.

He also says that from February to July all deposits, including time and demand deposits were expanding at an annual rate of 13 percent.

He ought to distinguish time and demand deposits because these are not both money in the same sense.

But the interesting thing is that in the preceding 3 years the total demand deposits rose by 4 percent, which is an amazingly small percentage in our kind of economy when you consider we are supposed to be growing at a rate of 4 percent a year and had some price increase. In the preceding years, I think about 7 or 8 years you had an increase in time and demand deposits from 3 to 4 percent.

Our economy tends to increase the supply of money about as rapidly as output rises and generally more so over the years because as we get richer we tend to hold more cash relative to our income. So I think when he suddenly shifted from this 13 percent increase, including time deposits, which he should not have included, and argues this is occasion for cutting down the supply of money, I think there are some weaknesses in that particular position.

Then he makes this point about intermediaries following his lead.

Then I raise again the point that Congressman Patman raised, that the Reserve increased bank loans only by $4 billion.

And he refers to the housing contributions. He does not say how much sooner the housing people got to work on this problem than the Federal Reserve did.

Well, that is it.

Then as to the bond prices on page 7 he talks a good deal about this shift from bonds to stocks and how terrible this is and it is a very serious problem in financing of the Government debt. There is no doubt about it. I think the Treasury has one of the toughest problems that I can think of in financing of its debt.

But I want to point out again that if you go all over the country shouting about the dangers of inflation and seeing more inflation than really exists that this contributes to this tendency to get rid of fixed interest yielding assets and seeing more inflation than really exists, that this contributes to this tendency to get rid of fixed interest yielding assets.

I read somewhere in the papers that Mr. Martin came back from Europe. I think he said something of this sort in this paper this morning, that there is a certain amount of doubt about the dollar abroad. This is a dangerous thing.

You know up to now for years and years we always talked about the dollar shortage. Now we are beginning to talk about the dollar surplus. Nobody wants dollars.

Mr. Martin came back, and I think in part to justify its dear-money policy, he came back and told us foreigners were concerned about our dollar. It is true we lost $2 billion of gold in 1958 and the rest of the world gained $3 billion in gold and dollars. Of course they gained all the new output of gold as well as the $2 billion they got from us. Does this indicate there is a great concern about the gold?

I talked to a number of experts on this, because I have been for years and years teaching a seminar in international economics, and I do not find any strong support for this position.

As a matter of fact, looking at the whole picture in the postwar the dollar on the whole has been awfully strong. If you look at it in terms of inflation we had the advantage because in general we had much less inflation than other countries. To some extent they adjusted for their inflation by devaluing. This is one thing that probably accounts to some extent for the loss of gold. Europe had devaluation this year.

I think that one should not, at least for the time being say that there is a considerable doubt in the dollar, there is a run on the dollar. If there is a run on the dollar it is said, we better clean house and balance our budget and spend no money and have a dear-money policy.

Now, he said:

> Prices of Government securities continued to decline under pressure of steady liquidation and the reluctance of investors to purchase market offerings in view of changed prospects for credit demands and inflationary threats.

But he does not say that the Federal Government issued $19 billion of intermediate and long-term securities in 6 months which was as important a factor as any in accounting for what happened.

And now he says: "About this time"—This is when he began in the summer of 1958—"inflationary expectations began to spread."

What do we find? We find that in the first half of 1958 the variations of the index number of consumer prices was from 119 to 119.2. That reminds me of the 1953 inflation that the Treasury saw and nobody else saw.

And so I think in that kind of a situation I have some doubts whether there should have been that kind of a policy.

One or two other points and I will be through in about another minute.

And then he says:

In the light of the rapidly changing economic situation, in many ways highly encouraging but with inflationary and speculative psychology spreading, the Federal Reserve, during the summer began to moderate the policy of credit ease with a view to tempering the rate of bank credit and monetary expansion.

He does not say anything about the 7 percent unemployed.

System open market operations after midsummer supplied only a portion of the reserves needed to meet rising credit demands and to offset the reserve drain of a continued gold outflow.

Well, there the point is he does not offset the losses of gold fully which of course makes the situation more difficult.

Then you again get the impression he is fighting the next recession. He is fighting the next recession by not treating the present recession, because the present recession is not going to result in inflation, which will bring the next recession.

And I will raise again this point about the much greater inflation abroad than here.

Now, he says:

In other words, the Treasury must be able to compete effectively and flexibly with other borrowers for the available supply of savings.

But that is not what Secretary Burgess said last year. He said the Treasury must not compete with other borrowers because the other borrowers have first lien on the funds.

Then he gives lipservice to growth but you must point out that if the recession costs you $50 billion that does to some extent cut down on your growth and on page 17 at the bottom there are certain reservations about, well, do we really have to take the increase of output too seriously.

He points out all kinds of reservations.

I think this in a sense implies an attempt to raise some doubts about whether we are not putting altogether too much emphasis on growth.

He says it all depends on output and demand but he does not say demand itself is the function of monetary policy.

Well, Senator, I guess that is it.

The CHAIRMAN. Thank you very much, Dr. Harris. We appreciate your testimony.

Congressman Patman.

Representative PATMAN. I appreciate your testimony, too, Dr. Harris. Of course, the chairman has a good time limitation on the members in order to give all of us an equal opportunity, which I think is very fine. And I must come within the 10-minute limit in the first go-around. I just bring up points without mentioning too much of your testimony.

Do you know of any other country in the world that issues tax-exempt securities, Dr. Harris?

Mr. HARRIS. At one time I taught that and I sort of watched it. I would say "No." I don't know any, but I wouldn't say this is absolutely sure because I may be wrong. I think that is true.

Representative PATMAN. I have been unable to see where any other country issues tax-exempt securities. Don't you think we have a real evil in the issuance of so many tax-exempt securities in this country?

Mr. HARRIS. I think there is a lot to be said about that, Congressman, like all tax exemptions. I think myself I would have argued up until recently that State and local governments are in such bad shape there is one way to help them finance themselves. The point is it isn't helping them much now.

Representative PATMAN. The interest rate difference is practically nil.

Mr. HARRIS. It doesn't give them much. I am not sure that is important.

Representative PATMAN. In regard to the Government bonds going down in price, the banks have a tax break on Government bonds that I just wonder if it contributes to the speculation in Government bonds and possibly causes them to go down. You see, if a bank buys a bond for 100 cents on the dollar then it goes down to say 85, it still carries it at 100 cents to the dollar. It doesn't affect the assets of the bank. That gives them a great advantage, of course. It is not reflected in their assets.

Mr. HARRIS. Don't they get a tax break, too, when they sell it?

Representative PATMAN. I haven't got to that. Excuse me just a minute.

Mr. HARRIS. All right.

Representative PATMAN. You see right now the banks have $67 billion worth of Government bonds. As to how much they are actually worth, I don't know. Nobody does because they are not carried, there is not any reporting. I think really it is dishonest bookkeeping because it doesn't reflect the actual values. So they have a great advantage there, and I just wonder if that helps them in the speculation and on the sale of the Government bonds. If they keep them 1 day, they get the benefit of capital gains. They don't have to wait 6 months.

Mr. HARRIS. Yes.

Representative PATMAN. They get a benefit there, and the tax losses, why it is 100 percent reduction on tax losses?

Mr. HARRIS. Yes.

Representative PATMAN. I just wondered if consideration should be given to change those. I don't even know whether they are laws or regulations or what cause it, but it is done. And I just wonder if that enters into the speculation of Government bonds in an unsupervised market? The Government bond market, of course, as you know, is not supervised. And it is just catch-as-catch-can and tooth-and-claw deal. It has nobody to regulate it or control it. Do you not think that is illegal, too, Dr. Harris, the fact we have no supervision of any kind over Government bonds?

Mr. HARRIS. Yes. This is, of course, a matter of degree. I myself feel for example, as I said, the bill's only doctrine, which is partly introduced in order to prevent any interference with the market——

Representative PATMAN. That is right.

Mr. HARRIS. Where the market has to be absolutely free. This is such an important market in this kind of crazy world we are living in that we have to have a strong Government security and market. I think there is something to be said for some control. Now the Federal Reserve when it goes out and buys Government securities to some extent does that. They had one break this year, that is, the Government market. The Government market would be worse if it weren't for the fact we lost $2 billion worth of gold, which made the Reserve buy $2 billion worth of Government securities to offset losses of gold.

Representative PATMAN. Of course, that was taken into consideration in reduction of reserve requirements.

Mr. HARRIS. Yes.

Representative PATMAN. You mentioned about loans of $1 billion more, but guarantees of $9 billion.

Mr. HARRIS. Yes.

Representative PATMAN. You refer, of course, in part to the Export-Import Bank loans, don't you?

Mr. HARRIS. Loans by any Government credit agency, yes.

Representative PATMAN. They are not counted in the budget?

Mr. HARRIS. Guarantees are not.

Representative PATMAN. Doesn't that make the budget somewhat fictitious and a little bit hypothetical?

Mr. HARRIS. Yes, and much beyond that. What happened to trust funds in the last 6 years? You find the biggest increase in trust funds, which don't get in the budget at all.

Representative PATMAN. That is right, social security. Now the money raised for the Export-Import Bank goes to other countries, or at least for the benefit of other countries, is just as inflationary as if we were to raise the money for the benefit of our own people, isn't it?

Mr. HARRIS. Yes.

Representative PATMAN. And I would like to comment further on this distressed area bill. We have a lot of distressed areas, Senator. Now if those distressed areas were in any of the other countries of the world, except the Iron Curtain countries, they have five agencies that they could get our money from to help them build facilities and projects to give employment to local people and relieve themselves. Those agencies are the World Bank; the Export-Import Bank, which is 100 percent U.S. Government money; the International Finance Corporation; the ICA, 100 percent Government money; and the Loan Development Corporation, 100 percent Government money, U.S. Government money.

Mr. HARRIS. Yes.

Representative PATMAN. Those five agencies are available to help out distressed areas or small business or big business or any other kind of business in all the countries of the world outside of the Iron Curtain countries—Mexico, Canada, all the rest, except here in the United States the distress area borrowers are not eligible.

Mr. HARRIS. Yes. Congressman, I think that is wrong. I think probably a good deal of this help to foreign countries is justified.

Representative PATMAN. I would like to equalize the thing. Give us domestic help rather than take away the foreign. Probably I used the wrong words. I have been voting for foreign aid, too.

Mr. HARRIS. I thought you had.

Representative PATMAN. I am not trying to make a statement against foreign aid.

Mr. HARRIS. I agree we should at least be fair with our own people.

Mr. HARRIS. Yes.

Representative PATMAN. When we are fair with other peoples of the world, we should at least be fair with our own people. That is the point I am trying to bring out.

Did you hear the questions and answers this morning, the questions propounded to Mr. Martin about the independence of the Federal Reserve System?

Mr. HARRIS. I got here about 11:20 and some of the conversation I couldn't get way back there but——

Representative PATMAN. You know out of the Constitution it is the duty of the President to take care that the laws are faithfully executed. That is a mandate in the Constitution of the United States. Of course, the Federal Reserve Act is a law just like any other law, and the President even appoints the Board members. You heard Mr. Martin say he didn't feel obligated; in effect, he didn't feel like the President had any power over the Federal Reserve System. Well, of course, I think that is terrible and it is an attack really on our form of government.

Mr. HARRIS. I think it is absurd myself.

Representative PATMAN. Beg pardon.

Mr. HARRIS. I think it is absurd.

Representative PATMAN. It is really terrible—in my book it is shocking—to think that an agency of the Government would try to declare its independence from the Executive under our form of Government where the Executive elected by the people every 4 years is charged with that duty to see that the laws are faithfully executed himself. The only thing that Mr. Martin finally said was maybe in some instances the President ought to refer it to Congress.

Mr. HARRIS. I would be almost willing to accept it if it would do any good. I don't think it does any good and then it raises the constitutional question as well.

Representative PATMAN. Beg pardon?

Mr. HARRIS. I don't think its independence results in better policy. I think it results in worse policy, if anything.

Representative PATMAN. Well, I have an idea I am ready to believe that Mr. Martin was appointed by President Truman to carry out his monetary policy of 2½ percent Government bonds. Don't you believe that?

Mr. HARRIS. I really don't know, Congressman. You know so much more than we do.

Representative PATMAN. I believe it. And Mr. Martin and the Board turned around and declared their independence of Mr. Truman. At that time Mr. Truman's popularity line was pretty low as you know. And they were looking for a chance for a long time to declare their independence. I think they took advantage of that time when Mr. Truman was kind of unpopular to declare their independence, and I think that was a terrible thing for them to do because they had promised——

The CHAIRMAN. I love my colleague here. I think that in all honesty I should say that I objected to Mr. Martin's appointment because I thought he would be too much under control of the Treasury.

Representative PATMAN. I know you did, but it turned out exactly the other way. And I thought he was appointed to carry out Mr. Truman's policies, and I believed that he was. I am not quoting anybody, but I am saying that it is my belief that Mr. Martin was appointed Chairman of the Federal Reserve Board to carry out Mr. Truman's policy to hold that interest rate over long-term Government bonds of 2½ percent.

Mr. HARRIS. Congressman, I was talking to one of the members of the staff this afternoon. It is almost impossible for the Secretary of the Treasury or for the Chairman of the Federal Reserve Board to be a hero. These are really tough jobs. I still think they make mistakes as well. They could do better. I do think this is a tough job being Chairman of the Federal Reserve Board.

Representative PATMAN. I know being a Congressman, House or Senate, is a tough job and they have to go on record about many things the same as we do. But they have more power in certain fields than we have, and in this case it looks like they have taken all our power, too. We want to see if we can't get some of that power back.

Now this morning I showed Mr. Martin from the Federal Reserve Bulletin just issued that out of the $12 billion which he made available absolutely free to the banks, that $10 billion of that was used to buy U.S. Government securities. In other words they bought those bonds, those securities, without cost to themselves absolutely free.

And another interesting thing, Dr. Harris, is that less than 2 percent of the banks were enabled to buy $8 billion of those bonds and the other $2 billion were bought by the 98 percent of the commercial banks. It occurs to me that some thought and consideration should be given that when Government securities cannot be sold to people who do not have the money with which to buy them and the Government knows that money has got to be created in order to buy those Government securities that some way should be created in order to buy those Government securities, that some way should be found that is not inflationary, and I know that it can be found that is not inflationary to sell those securities to the 12 Federal Reserve banks or to the Open Market Committee, the New York bank. Then the people, we taxpayers, will pay interest on them, but it will flow back into the Treasury, and it will be much better than to permit the commercial banks to create the money in the same way in order to buy those bonds.

Do you not think there is some logic behind that, Dr. Harris?

Mr. HARRIS. Congressman, as you know, and I am sure Senator Douglas knows, this is an issue that has been discussed by economists for a long time. There are a great many of them who believe that here you have this business of creating money which the Constitution says belongs to the Congress, and, of course, you do have the banks creating money by virtue of rights given them by Congress; and there have been all kinds of discussions about how you might cut down the profits of this kind of operation, how you might require these banks to hold larger reserves against these purchases of Government securities. There is lots to be said here. This is really a problem, and you are going to run up against a tremendous amount of resistance against that kind of change.

I certainly think one could raise some reasonable arguments that the banks have taken over the function of the Government, and because of this perhaps there should be some limitations on their profits or something of this sort, particularly when they purchase securities.

Representative PATMAN. Since you mentioned the reserves, right now the 12 Federal Reserve banks have approximately a billion dollars in surplus. They do not need that money. I interrogated them in the fall of 1957, each one of the Federal Reserve Board members, and not a one of them could give any reason for having that money in surplus. They will never use it. They will never need it. Why should they need it, when they have the power to create money when they need it? Why should not that money be put in the Treasury and reduce the national debt a billion dollars? It is not invested now. It is idle and unused in these 12 Federal Reserve banks, and we are paying interest on an equal amount because we do not have it in the Treasury. I think the Federal Reserve should turn it over because they do not need it and they do not use it.

Thank you, Mr. Chairman.

The CHAIRMAN. Congressman Reuss.

Representative REUSS. Mr. Chairman, Mr. Harris, the statement was made at the hearings yesterday by the Treasury Department's debt management expert that interest rates were not determined by anything the Treasury or the Federal Reserve did but were determined by supply and demand. Would you care to comment?

Mr. HARRIS. I surely would. I said at the outset I think Mr. Martin is a relative high type of public servant, and he is a man of ability, and he is candid; but in looking over the few thousand of pages in the Senate Finance Committee, one thing that really annoyed me was one or two occasions when he said, "We have nothing to do with the rate of interest. We just follow the market."

If that is all they do, I do not know what they are there for. Obviously they are going to have some influence on the rate of interest because they are trying to control the supply of money, and the supply of money does influence the rate of interest because if there is more money you can buy, for example, assets and not increase the price of assets. This is a reduction of rate of interest.

You had a second facet on that question. What was it about besides the rate of interest?

Representative REUSS. I wondered whether the Treasury also could influence the rate of interest.

Mr. HARRIS. Yes, but the Treasury. You said the Federal Reserve—the Treasury. There was a statement, you know, when Mr. Burgess really got caught on that 1953 episode. I don't think he ever quite forgot it. Mr. Burgess had written a book, and he had not learned that what you write as an expert as an author and say this is the kind of policy we ought to have, that that is one thing; but when you go in and take an important job of responsibility and try to apply what you wrote in a book, this raises a lot of questions. Burgess had been taught the thing to do was to make the debt longer, maturity average, and you would get the debt out of the banks so he immediately floated this 3¼-percent bond issue. By virtue of the fact, of course, he influenced the rate of interest. So any organization such as the National Government that issues $50 billion worth of securities a year, including refunding and what not, is bound to influence the rate of interest.

He says, "No, we accepted the market rate of interest. We had nothing to do with the change of rate of interest."

You get that out of the Treasury often. It is a lot of nonsense.

Representative REUSS. Having heard your testimony that the Government, through the Treasury and the Federal Reserve does have something to do with the rate of interest by controlling one of the elements of inflation, the supply of money, I would like to have your views on whether the present level of interest rates, particularly the long term rates, encourages the maximum amount of capital accumulation and economic growth.

Mr. HARRIS. Of course, the rate of interest now is certainly high by recent standards, in fact by standards in the last generation. The Federal Government borrowed 4 percent long term. That is a high rate of interest. We all know that the amount of investment depends to a considerable extent on the rate of interest and business compare interest rates and what they expect to earn when they borrow. If you borrowed at 4 percent you have to earn more than that or expect to before you borrow. If the rate is 2 percent, you are more likely to borrow more money. So I think on the whole, all other things being equal, it is better to have a lower rate of interest. Now you can get to a point where by increasing the supply of money, you bring the interest rate down to a point where you may have to deal with inflation.

I would say on the whole—I think Senator Douglas said something like this this morning, if I understand him correctly, that he was concerned about his own party's administration in the forties of getting the rate of interest down too much. There is some defense for this in wartime. But in postwar there is less defense. I think he said, and I certainly agree, if he did say it, that we moved too much in the opposite direction in recent years.

Is that correct, Senator?

The CHAIRMAN. That is correct. Would you agree with that?

Mr. HARRIS. I agree with that.

The CHAIRMAN. Do you agree with the latter part?

Mr. HARRIS. That would be my position.

Representative REUSS. Would you agree with the philosophy of the Treasury-Federal Reserve accord of 1951 to the extent it held that the Federal Reserve should not, during an inflationary period, augment the money supply and relax credit just to accommodate the needs of the Treasury?

Mr. HARRIS. Yes. Of course, I think this is true. In the old days when I was brought up as an economist and in the early twenties, we always talked about how you will influence the rate of interest through the supply of money. You have more savings that reduces the rate of interest; and then, in the twenties we developed the theory that you influence the rate of interest through the supply of money. But one must not forget that in more recent years we are well aware of the fact we can influence the economic situation in other ways as well as through the rate of interest and monetary policy.

For example, I would have argued that if we really were in great danger of inflation in 1957 that possibly we could have increased our taxes. This politically would have been very difficult, and this is where you will have the conflicts of what is good economics and what is good politics, you see.

Representative REUSS. Is there anything in the 1951 accord which should prevent the Federal Reserve, during a recession, from assisting in debt management?

Mr. HARRIS. No. I think the whole idea, and I think Senator Douglas is much more expert on the 1951 accord than I am, but I say the whole idea of the 1951 accord was—and I do not know whether Senator Douglas would agree with this—I always feel that the 1951 accord did not mean that the Federal Reserve was to be independent; it merely meant that the Federal Reserve was not to be the slave of the Treasury in getting down the rate of interest in order to save money for the Treasury. But it does not mean at all that the Federal Reserve cannot go out and make cheap money to get us of a recession, you see.

Representative REUSS. If that cheap money also happens to help the Federal Government, only a sadist would object—don't you agree?

Mr. HARRIS. I would not argue even that it might be necessary to help the Federal Government and purchase some of these securities even if it does bring about some inflation and that might still be consistent with the 1951 accord because the position of the Federal Treasury is an important part of the economy.

Now I think the criticism before 1951 was that the interests of the Treasury were overdone. I think in recent years interest of the Treasury has been disregarded.

Representative REUSS. It is said by people, who oppose the notion of even modest suggestions by the Executive to the Federal Reserve on its monetary and credit policy, that public discussions of future changes in the rediscount rate would have very undesirable consequences.

Mr. HARRIS. I think it might be unwise for, say, the Treasury to come out and say, "We think you ought to increase or reduce your rate." They would probably say, "You ought to reduce your rate." I think what really is desired is the Treasury and all the other credit agencies and if the Federal Reserve would get together and decide what is the best policy for the Government and all operate accordingly. Now they move in all kinds of directions, and that is what I think is the weakness in present policy.

Representative REUSS. You would say, therefore, that while the Executive should not interfere in the day-to-day operations of the Federal Reserve or the other credit agencies, for that matter, the President is obligated under the Employment Act to do more in recommending monetary and credit policy than is contained in this year's "Economic Report." The only word I find on the subject is on page 52 where it stated that "appropriate monetary, credit, and debt management policy" would help to achieve price stability.

Mr. HARRIS. That is not saying very much, is it? But the President's own statement does not have a word about monetary policy, which I think is the crucial thing in the record. I may be wrong, and you are more experienced than I am.

Sometimes you find exactly the same words in the President's policy statement as in the report. I thought what really counts was the few pages the President presents because this is the administration policy. Am I wrong on that?

Representative REUSS. You think, in short, that not much guidance has been given on monetary policy.

Mr. HARRIS. That does not say anything. It seems to me it is up to the President to say something. He argued he has nothing to do with the Federal Reserve. "This is their problem, an independent organization, and I won't touch them."

Representative REUSS. Thank you, Mr. Harris.

The CHAIRMAN. Senator Javits.

Senator JAVITS. Mr. Harris, I appreciate the presentation for you are helping us.

Mr. HARRIS. Senator, I am glad you are here. I was wasting all my ammunition on Democrats already converted.

Senator JAVITS. I just arrived and was attending another meeting. So I will content myself with being interested in your ideas from your statement.

The CHAIRMAN. Congressman Brown.

Representative BROWN. Thank you, Senator, very much.

I enjoyed this presentation very much, Dr. Harris.

I am particularly intrigued with a very good point you make, that it is awfully easy to pick a whipping boy on these things when it is a combination of a lot of factors. If I might think out loud here just a second, there has been a lot of talk, of course, about the influence of wages in the cost-push theory.

Mr. HARRIS. Yes.

Representative BROWN. Here are some interesting figures. Wages and salary disbursements have gone up in 10 years approximately 80 percent.

Mr. HARRIS. This is total payments?

Representative BROWN. Total payments. Advertising expenditures in this country in the same 10 years have gone up 144 percent. Do you feel we might overlook that as a factor?

Mr. HARRIS. Congressman, what you say certainly is relevant. If you may recall, in my paper, I quoted a Miss Mack in the National Bureau of Economic Research. She said the same thing. You are making a narrower contention. She argued a good part of the explanation of inflation was not merely the increase in wage rates. There is a much larger ingredient of nonproductive workers, the salesmen, the advertisers, the service people of all kinds. This tends to raise the general price level much more than could be explained by increases in wage rates.

Representative BROWN. Don't you feel, too, Dr. Harris, that during the past 10 years we have gone through a period of what I would term, perhaps, an overinfatuation with the technological improvements at times? Some of these technological improvements have not delivered the efficiencies that some of the optimists figured they might, do you think?

Mr. HARRIS. That is true and that is another point Miss Mack makes. She says businessmen tend to overestimate the importance of the IBM, et cetera, and therefore, they do not get a corresponding gain in output.

Representative BROWN. And the net result then has been that through the combination of the factors we have had an inflation for which there is really no whipping boy, be it one segment of the economy or the Government or anything else. It is just a combination of factors.

Mr. HARRIS. It is a combination of factors, that is perfectly true, and labor, nonlabor, government, they all contribute to some extent.

Representative BROWN. Senator Douglas brought out an excellent point this morning to Chairman Martin that the feeling is that perhaps we have reached the point of leveling off in this. Do you feel that we have?

Mr. HARRIS. It is awfully hard to say. I would say on the basis of what we know on the last half year and the way it looks to me that the inflationary dangers are not great and I would certainly not have a policy of monetary restraint at this point in view of what happened in the second half of 1958.

Representative BROWN. You did not hear, perhaps, Chairman Martin's theory of flammable materials lying around that could ignite another spiral of inflation. Are you saying that you don't feel the danger is that great, that the materials aren't so flammable?

Mr. HARRIS. I didn't hear him make that statement. As I said before, I think it is a great mistake to overemphasize the dangers of inflation, because that is just what helps bring about inflation. I think it is very lucky for this country that most people aren't inflation minded and that all the people do not behave the way these investment trust people do, all buying equities now and dumping their bonds on the market. As I said in the last part of my statement I do not see any real danger of inflation immediately ahead. If we go up in price 2 percent or more a year, I would be more strongly in favor of current Federal Reserve policy and inclined to use tax restraints, also.

Representative BROWN. If I might proceed with two questions, I was also impressed with the statements you made that the real hardship of inflation falls upon the retired and disabled, the nonproducers in society.

Mr. HARRIS. Yes.

Representative HARRIS. Even if the inflation levels off would you agree that perhaps it is already above the reach of our retired, many of our retired?

Mr. HARRIS. Oh, yes. Our old-age and survivors insurance average monthly benefit is $60 now. That is not an awful lot to take care of either one or two old people. I think, aside from inflation, there ought to be some inflation of these benefit payments.

But I was arguing that rather than bring about a recession because you are excessively fearful of a small rise of prices, it might be better not to put quite as much emphasis on the objective and use some of your resources to correct or treat the disease of inflation of those who really suffer and they are primarily the old people and it wouldn't cost you very much, not nearly as much as a recession.

Representative BROWN. In other words, would this be a fair statement? Rather than to put a lid on the growth and development of 85 percent of the population, who are producers, and gear the society and the economy to the 15 percent who are nonactive, it would be much better for the 85 percent to carry the 15 percent along. Is that correct?

Mr. HARRIS. You have said it much better than I have ever said it.

Representative BROWN. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. I wish to say you have asked extremely penetrating questions.

Representative BROWN. Thank you.

The CHAIRMAN. I do not intend to carry on the discussion any further.

I sometimes have thought, when in a semihumorous mood, that perhaps we should have the platoon system for the Federal Reserve Board. We should let the bankers operate in the periods of prosperity when they would hold down the tendencies of us politicians, but that in a period of unemployment and recession and depression we should replace them and put the politicians in control at the Federal Reserve Board. They would follow an expansionist policy. I know there is some difficulty in getting the policies sufficiently flexible so as to meet the requirements of the business cycle. But I do think that the central bank authorities all over the world, who perhaps protect themselves against tendencies of politicians to appropriate and not tax, have an undue concern in periods of recession about price stability.

Thank you very much, Dr. Harris.

We will have a session on Monday in the Old Supreme Court Chamber, this wing of the Capitol, at 10 o'clock.

Mr. Walter Reuther will testify on the Economic Report and at 1:30 Mr. Walter Fackler and Mr. Ralph Robey, representing respectively the Chamber of Commerce of the United States and the National Association of Manufacturers will testify; then in the afternoon will be testimony by a panel of group representatives.

(At 4:17 p.m. the hearing was recessed to reconvene at 10 a.m. Monday, February 9, 1959.)

# JANUARY 1959 ECONOMIC REPORT OF THE PRESIDENT

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MONDAY, FEBRUARY 9, 1959

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met at 10 a.m., pursuant to recess, in the Old Supreme Court Chamber, Hon. Wright Patman presiding.

Present: Senators Douglas (chairman) and Sparkman and Representatives Patman (presiding), Bolling, Reuss, Kilburn and Widnall.

Representative PATMAN. The committee will please come to order.

Senator Douglas is detained a few minutes and he requested that I get the committee started. We have a panel this morning—representatives of labor and management commenting on the economic report.

First we will have labor's comments by Mr. Walter Reuther, vice president of the American Federal of Labor-Congress of Industrial Organizations for 1 hour.

Then we will have management's comments for a half hour, Mr. Walter Fackler, Department of Economic Research, Chamber of Commerce of the United States, and one-half hour Mr. Ralph Robey, economic adviser, National Association of Manufacturers.

Mr. Reuther, you have the first hour. Are you ready to proceed, sir?

Mr. REUTHER. I am, sir.

Representative PATMAN. You may proceed.

## STATEMENT OF WALTER REUTHER, VICE PRESIDENT, AMERICAN FEDERATION OF LABOR-CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. REUTHER. Mr. Chairman, I appreciate the opportunity of appearing before your committee. I come here as vice president of the AFL and the chairman of its economic policy committee and also as the president of the United Automobile Workers Union.

I have prepared a statement which I would like the privilege of putting into the record.

Representative PATMAN. Without objection it will be inserted at this point and you may proceed in any way you desire.

Mr. REUTHER. Very well.

I would like to supplement that with an oral statement.

(The formal statement referred to is as follows:)

STATEMENT ON THE "PRESIDENT'S ECONOMIC REPORT," PRESENTED ON BEHALF OF THE AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS BY WALTER P. REUTHER, PRESIDENT, UAW–AFL–CIO, VICE PRESIDENT, AFL–CIO, AND CHAIRMAN OF THE AFL–CIO ECONOMIC POLICY COMMITTEE

These hearings are being held at a time when our failure to restore the economy to health and growth is not only causing needless hardship and suffering for millions of American families, but has brought us to a critical point in the worldwide struggle between freedom and tyranny.

Our difficulties, both at home and abroad, arise out of no lack of physical or human resources. Our problems flow from a lack of vision and determination—a failure to appreciate the vast growth possibilities of the American economy, an absence of determination to translate those possibilities into reality. We are in trouble not because we lack the means to solve our problems but because we are not trying.

At home, our failure to achieve a rate of economic growth in accordance with our potential has meant long months of unemployment for millions of men and women. It has brought tragic hardship to families, forcing the curtailment of their spending on food and other necessities, and dissipating their savings. As savings and unemployment compensation benefits were exhausted, unemployment has brought mounting welfare rolls to State and local governments. While men and women search vainly for jobs that do not exist, our Nation has suffered the loss of tens of billions of dollars in goods and services that idle hands and idle machines could and should have produced.

At the same time our position of international leadership is threatened by the same failure of our economy to match actual growth with its possibilities for growth. In recent weeks and months we have been forced to recognize that in certain areas of scientific achievement and the military potential flowing from it, the United States no longer enjoys the commanding lead we once held over the Soviet Union. Even in terms of general economic strength, although we are still ahead, the Communists are rapidly closing the gap between us. The failure of the U.S. economy in recent years to grow as it can and should is one of our major sources of weakness. It has weakened us not only in terms of physical strength, but in the struggle for men's minds, and hearts, and loyalties.

It is urgently necessary that we find prompt and effective answers to our economic problems. Failure to do so means acceptance of the suffering and loss that unemployment and economic stagnation cause for our own people, an acceptance of hardships as unjustifiable as they are unnecessary. In addition, our position as a leader among the forces of freedom requires that we prove, through example, that full employment, full utilization of productive resources and steady economic growth can be achieved at least as effectively within the framework of freedom as under a Communist dictatorship. In the present crisis we need to understand and to act in the knowledge that halfway and halfhearted measures and policies of too little and too late will not meet the infinitely complex challenge of peace as we have always understood that they are not equal to the challenge of war. Hundreds of thousands of unemployed workers in great industrial centers like Detroit, Pittsburgh, and Chicago, who manned the defense plants during the war, are asking the question to which Americans must find an answer. They ask: "Why is it that America can demonstrate the courage, the good sense and the know-how to achieve full employment and full production making the weapons of war and destruction but does not have the comparable will and courage and good sense to achieve full employment and full production making the good things of life for people in peacetime?" I earnestly hope that this committee will have the vision and the courage to face unpleasant facts boldly and to recommend to the administration and the Congress vigorous, effective action designed to restore our economy to health and to stimulate a resumption of economic growth at the high rate of which it is potentially capable.

The facts of our relative decline cannot be denied. The total production of goods and services in the United States, for example, may still seem far ahead of that of the Soviet Union; we are probably still producing a little more than twice as much as they are. But economic growth in the Soviet Union is advancing four or five times as fast as our lagging economy has grown in recent years. If both economies continue simply to grow at the same pace as they have done respectively since 1950, it will be a mere 17 or 18 years until Soviet production can match and surpass ours in volume, and from that point forward it is they who will threaten to take a commanding lead.

If we should lose this race, it will not be primarily because Russia has surged ahead so fast, but because we have lagged so far behind. Our failure has been essentially the result of faulty economic policies. We have the physical means and the technical skill to achieve continued expansion at three or four times the pace of actual growth since 1953. As I shall show, there is persuasive evidence that productivity over the long run tends to increase at an accelerating rate. Given favorable economic conditions, our productivity at the present time should be increasing at a rate in the neighborhood of 4 percent per year. Add to this the effects of population growth, and our economy should be expanding, at the very least, at a rate of 5 percent per year. A rate close to that was achieved during the period from 1947 to 1953, but from 1953 through 1958 the annual rate of growth has averaged closer to 1½ percent.

The realities of the world situation necessitate that America and the free world build adequate military strength. However, we must clearly recognize that in the face of the developing technology of nuclear and missile warfare the Soviet Union is shifting its offensive to the economic front and will continue to place increasing emphasis on programs of economic penetration and political subversion. According to a report in the New York Times of January 30 last, Premier Khrushchev in his report to the 21st Communist Party Congress specifically related increases in Soviet production to increased aid to other Communist countries. In addition, however, the Soviets have also been increasing their economic assistance to uncommitted nations with underdeveloped economies. A significant example is Egypt's Aswan Dam, a project of enormous importance to that country's economic development, which is now in process of construction financed by a Soviet loan. Every ruble's worth of such aid carries with it a propaganda message of growing Soviet strength. Yet when it is suggested that American aid programs should also be increased, men of little faith have repeatedly told us, "We can't afford it." This is the voice of defeatism that would measure America's power to act only within the limitations of our present depressed economy and the boundaries of narrow vision. We must realize that only by following policies based on confidence in America's potential economic strength can we transform economic promise into practical economic fulfillment. Only by adopting programs, at home and abroad, which will expand our power to consume and make new demands on our power to produce can we stimulate the economy to respond to those demands and achieve the full utilization of our productive capacity.

The need for such a stimulus is painfully evident. While the forces that threaten our freedom have been building up their economic strength, our economy has been allowed to lag, to stagnate, and even to slip backward. Employment in the United States today is less than it was 3 years ago. There are 1.7 million fewer nonfarm jobs than when the recession started. Even after some industrial recovery, approximately 22 percent of the Nation's productive capacity still stands idle.

Tens of billions of dollars of goods and services that could and should have been produced have been lost in the past year alone. Over the past 5 years, the difference between what our halting economy has actually produced and what we could have had with full production, full employment, and full realization of our potentialities for growth, would come to substantially more than $200 billion. This production that we have now forever lost could well have spelled the difference between an unchallenged continuation of United States world leadership and the threatened, uneasy position in which we find ourselves today. The unrealized economic growth and the economic abundance that it would have made possible are not only the margin of economic prosperity and higher living standards. In this period of world challenge they are the margin of survival.

Economic distress has been enveloping an increasing number of industrial centers. Hundreds of thousands of people in these distressed communities have lost their jobs and are without hope of finding useful employment unless the Federal Government provides effective and adequate leadership to get the American economy into high gear and to achieve full employment and full production. State and local government revenues have been affected, while welfare needs have risen, threatening many State and local governments with an inability to meet operating expenses.

According to the Labor Department's report of a few days ago, 76 of the Nation's 149 major labor markets and 183 small industrial centers report substantial unemployment. This compares with substantial unemployment in 24 major and 61 small labor market areas in July 1957, just before the recession started. The 1959 outlook for most of the present distressed areas is bleak, unless there is decisive action to adopt national policies which will quickly stimulate economic growth and restore full employment.

While the economy has been drifting without direction and so much of our productive capacity has been idle, vast private and public needs of our people, as well as a large part of our responsibilities as a leader among nations, have been left unmet.

According to the Bureau of the Census, in 1957 there were still almost 25 percent of American families, not counting single persons living alone, with incomes below $3,000. One need not have a doctor of philosophy degree in economics to know that in these more than 10 million families there exists a vast reservoir of needs which simply cannot be satisfied on an income of less than $3,000—needs which, if they were to be met, would keep our factories operating at full capacity for years to come.

In fact, the picture of poverty in America is even darker than that one figure would indicate. There are 6.5 million families, over 15 percent of the total, with incomes under $2,000, including 2.8 million with incomes below $1,000. The elimination of such poverty still presents a tremendous and pressing challenge to America.

As a Nation, we have hardly begun to meet the public needs of our growing population—as witness the critical shortage of educational facilities in almost every community, the vital need for more hospital beds, the continued existence of slums and substandard housing, both urban and rural, the inadequacy of our highways and the continuing deterioration of industrial and commercial properties to be found at the core of many of our cities. In many important areas of our country, we are tragically neglecting the development of our resources, upon which both the security and the prosperity of our country depend.

In informed quarters, serious doubts have also been expressed as to whether our vital defense requirements are not being subordinated to the demand for a balanced budget.

I have already referred to the expansion of Soviet aid to underdeveloped countries—a challenge which so far we have failed to comprehend fully, but which we must face if we are to avoid the tragic results of hundreds of millions of uncommitted people coming under the domination of the Soviets. We are losing ground dangerously in the contest for the hearts and minds of the peoples of the economically underdeveloped countries who, in the long run, will tip the balance in favor of freedom or tyranny. America is losing this struggle today not because our system of freedom is unequal to the challenge. We are losing, unfortunately, because we are not trying.

One of the imperatives of world leadership today is that we recognize the rapidity with which people around the world are emerging from colonialism, political or economic, into full-fledged nationhood. As they find their way upward, they seek not only political independence, but a rapid improvement in standards of living which can be achieved only if they can obtain from more advanced countries substantial assistance in economic and industrial development.

We in America will be guilty of criminal shortsightedness if our reply to their appeal is, "We can't afford it." We will be creating ideal conditions for the Soviet propagandists who will move boldly to fill the vacuum created by our failures.

The most optimistic spokesmen of the steel industry estimate that a substantial proportion of its productive capacity will be idle during 1959. Continuing idle capacity will be found in our machine tool and machinery industries, in our farm implement industry, in our truck manufacturing industry—in all the plants whose products the underdeveloped countries so badly need. Are we to say that we cannot afford to get those industries back into operation, are we to say we lack the will as a free people and the know-how to put the unemployed Americans back at work to meet those compelling needs? If we have any intention at all to demonstrate the superiority of a free society over a Communist dictatorship, we must insist that we cannot afford not to. We cannot afford to give the Soviet propagandists an opportunity to say to the peoples of these new nations, "America has idle plants and unemployed workers enough to meet all your needs—but their economy is so faulty that these resources must lie unused." What answer to such attacks can we find, except to make them untrue by demonstrating the power of democratic performance?

These issues, upon which the destiny of the world may be decided in this last half of the 20th century, are not discussed in the President's "Economic Report." They were ignored in the administration's budget presentation to Congress, which proposed curbs and cuts in essential national programs.

The administration's obsession with balancing the budget at low levels of receipts and expenditures, which is to say at low levels of national output, is an invitation to continuing economic stagnation at home and to loss of prestige and leadership abroad.

The low rate of growth with which the administration seems content contrasts sharply with the concept of a dynamic, expanding economy, and also with the vast potentialities for growth which are inherent in our advancing technology.

The President's obsession with balancing the budget has blinded him to the economic truth that a balanced budget is possible only as a byproduct of an economy balanced at full employment, full production levels.

### EXTENT OF THE DECLINE AND PICKUP

The effects of the recession are still present. The pickup that started last May has not solved the problem of unemployment and idle productive capacity, by any means. A relatively slow improvement in 1959—such as most observers expect—will leave a persistent and serious problem at the close of the year.

The recession came after several years of relative stagnation. From the middle of 1953 to mid-1957, the Nation's real total output, including services, rose at an annual rate of 2.2 percent. The population increased at a faster rate than the 1.6 percent yearly advance of the output of factories and mines.

The economy was operating considerably below capacity during most of those 4 years. This can be seen in the large amounts of idle industrial capacity during most of this period—only for a few months at the end of 1955 and in early 1956 was industrial output at a high level in relation to capacity. It can be seen, too, in unemployment—the number of jobless was 5.6 percent of the labor force in 1954, 4.4 percent in 1955, 4.2 percent in 1956, and 4.1 percent in the first half of 1957.

The sharp economic decline between the summer of 1957 and April 1958 wiped out some 3 years of snail's pace advance. At the recession low point, the volume of national output, which had dropped almost 6 percent, was back at the level it had reached in the first half of 1955. Industrial production had fallen over 13 percent and was back to where it had been in the fall of 1954. Nonfarm jobs were cut 2.4 million—almost 4.6 percent—and were at the level of the late spring of 1955. Working hours were cut back drastically, to a level lower than any since the end of the war. Industry, generally, was utilizing merely 65 percent of its capacity to produce; 35 percent of capacity was idle. The number of jobless rose to 5.2 million, or 7½ percent of the labor force, seasonally adjusted.

By the end of 1958, after 8 months of pickup, production was almost back to the prerecession levels of mid-1957, but employment lagged far behind. Real national product had almost returned to where it had been when the recession started. Industrial production had recovered 85 percent of the recession's decline. Corporate profits were almost back to prerecession peaks. But nonfarm wage and salary jobs recovered merely 30 percent of the recession loss, between May and September, and, then, remained the same through December, except for seasonal changes. The number of nonfarm jobs recovered only to where it had been in the fall of 1955. About 22 percent of industrial capacity was idle. The number of jobless was over 6 percent of the labor force.

*Employment lags far behind output*

| | Gross national product (Annual rate in 1958 dollars) | Industrial production (1947–49=100) | Nonfarm wage and salary jobs |
|---|---|---|---|
| *1956* | *Billions* | | *Millions* |
| First quarter | $443.4 | 143 | 51.3 |
| Second quarter | 444.1 | 142 | 51.8 |
| Third quarter | 445.1 | 141 | 51.8 |
| Fourth quarter | 451.5 | 145 | 52.2 |
| *1957* | | | |
| First quarter | 452.4 | 145 | 52.2 |
| Second quarter | 453.7 | 144 | 52.3 |
| Third quarter | 453.3 | 145 | 52.4 |
| Fourth quarter | 444.4 | 139 | 51.8 |
| *1958* | | | |
| First quarter | 427.7 | 130 | 50.7 |
| Second quarter | 429.0 | 129 | 50.2 |
| Third quarter | 438.6 | 136 | 50.6 |
| Fourth quarter | 451.5 | 140 | 50.7 |

Source: Council of Economic Advisers, Federal Reserve Board and Department of Labor.

If we look at the record of manufacturing industries alone, since the recession low point, we find a somewhat slower rate of recovery of the production decline than in upturns from previous recessions and a much slower recovery of the job loss. From the April 1958 low point to December 1958, 84 percent of the recession manufacturing production loss was regained, compared to a 26-percent recovery of the manufacturing job loss. It required a recovery of 3.23 percent of the production loss to regain 1 percent recovery of the job loss. In the similar period of upturn from the 1954 recession, recovery of 2.33 percent of the production loss was enough to restore 1 percent of the employment loss; and in the pickup from the 1949 recession, a 1.78-percent recovery of the production decline was sufficient to wipe out 1 percent of the job loss.

*Comparison of upturns from postwar recessions—Recovery of recession loss—8 months from low-point manufacturing industries*

| Eight months after low point | Recovery of production loss | Recovery of employment loss | Percent of recovered production loss per 1 percent recovery of job loss |
|---|---|---|---|
| | *Percent* | *Percent* | *Percent* |
| October 1949 to June 1950 | 128 | 72 | 1.78 |
| August 1954 to April 1955 | 93 | 40 | 2.33 |
| April 1958 to December 1958 | 84 | 26 | 3.23 |

Percentage changes are based on seasonally adjusted data for manufacturing production and employment.

Source: Department of Commerce, Business Statistics; Council of Economic Advisers, Economic Indicators.

This comparison indicates a significant difference between the current upturn and pickups from previous postwar recessions—the growing impact in manufacturing industries of automation and rapid technological change. It indicates, too, the seriousness of the employment lag.

When we examine the entire period since the end of the Korean war—from mid-1953 to the end of 1958—we find a record of shocking stagnation. In those 5½ years, real national output of all goods and services rose at an average yearly rate of under 1.6 percent. As for the basic industrial part of the economy, the output of factories and mines increased at a rate of merely seven-tenths of 1 percent per year.

The pickup in output since the recession low-point is accounted for largely by a rapid rise in productivity, following a decline that occurred during and was caused by the downturn. The great gap between the upturn in production and the slow pickup in jobs can be only partly explained by an improvement in working hours. In manufacturing, for example, the length of the workweek rose from 38.3 hours in April 1958 to 39.9 hours in September 1958, followed by a small seasonal increase to 40.2 hours in December. The major part of the gap between the rise in output and the substantial lag in jobs can be explained only by a rapid advance in output per man-hour.

The sharp rise in productivity has meant lower labor costs in many industries and, when combined with the upturn in production, it has meant increased profit margins. Corporate profits, along with productivity, have risen sharply in the past 9 months, from the recession low-point.

Where is the national economy at present? Output has returned to about the level of mid-1957, leaving a substantial amount of unused capacity. Nonfarm employment has recovered only to where it was more than 3 years ago and more than 6 percent of the labor force is jobless. Despite the pickup since last May, economic activity is still no greater than it was about 2 to more than 3 years back.

There is a long road ahead, before employment can reach prerecession levels. It will take a substantial and continuing rise in sales and output to produce 1.7 million new nonfarm jobs.

Serious problems will remain, however, even when employment returns to prerecession levels. In the past 3 years, the labor force has grown and business has expanded its capacity to produce. Between the fall of 1955 and the present time, the labor force has grown more than 1½ million. There are more people able and willing to work and seeking jobs.

There is a much longer road ahead, before the national economy can reach full production and full employment. The task of national economic policy should be to speed our advance along that road so as to achieve an expanding, full employment economy as soon as possible.

## THE CONSUMER IS KEY IN 1959

The sharp decline between the summer of 1957 and April 1958 was cushioned by effective collective bargaining, the increased percentage of the labor force in service and salary jobs that are less subject to layoffs and by unemployment insurance. Personal income held up rather strongly, in the face of cutbacks of production, jobs, and hours of work.

While business investment in new plant and equipment, business inventories and Federal Government expenditures fell, collective bargaining, shifts within the labor force and unemployment compensation offset a large part of the drop in personal income that otherwise would have occurred. As Prof. Sumner Slichter has stated: "* * * by far the most important cause of the steadiness of personal incomes [during the decline] * * * is the rise in hourly earnings of wage and salary workers."

Other forces worked to bring about an upturn, while the decline was being cushioned. The Government belatedly reversed its tight money policy in the fall of 1957. State and local governments continued to increase expenditures, particularly for roads and schools. Congress adopted measures to make available additional funds for mortgages for moderate-price homes and to step up roadbuilding. The administration sharply increased orders for defense goods, after having cut back such orders severely in the first half of 1957.

What factors, however, can be expected to raise output, sales, and employment in the months ahead?

Much less push is expected from the Federal Government than in the past year. If the administration has its way, the Federal Government will be, to an increasing extent, a depressing factor on the level of economic activities in 1959, by curbing and cutting its programs. Even if the administration does not fully succeed in its effort, there is a danger that the Federal Government may be a restrictive factor in the second half of 1959, through curbs and eliminations of some current Federal programs. Furthermore, the Government resumed its tight money policy last summer. This tight money policy may restrain economic growth, as 1959 moves on, particularly in the field of residential construction.

State and local government expenditures are expected to continue to increase in 1959, adding moderately to sales, output, and jobs—particularly in highway and school construction and education services. But this continued rise is not assured, by any means. The recession and the persistence of large-scale unemployment have created financial difficulties for many States and critical conditions in several of them. In addition, the Federal Government's tight money policy makes it more expensive for States and local governments to borrow money, thus raising costs, which may result in the postponement of expenditure programs.

As for foreign trade, there is nothing to indicate that the recent excess of exports over imports will increase significantly in the months immediately ahead. The economic outlook for 1959, therefore, largely depends on business and consumer activities.

Can we expect a substantial rise in business investment in new plant and equipment in the period immediately ahead? I do not believe that such expectation is realistic. With about 22 percent of productive capacity still idle, a substantial rise in business investment cannot be expected immediately. Much of any early increase in business investment will probably be for modernization, rather than expansion of capacity—programs that would reduce costs but would also reduce job opportunities. A significant increase in business spending for new plants and machines depends on a continuing, rapid increase in sales and production that will enable business to operate at maximum levels. The needed continuing rise in sales must come mainly from the consuming public.

In the light of merely a moderate rise in sales and output to be expected from the combined activities of Federal, State, and local government expenditures, business investment and foreign trade, the key to the level of economic activities in 1959, therefore, is the consumer. Only a continuing and rapid increase in production and sales—largely dependent on consumer spending—can provide the basis for achieving high levels of production and employment in 1959.

A substantial rise in consumer spending in the months immediately ahead, however, will largely depend, in turn on consumer buying power.

An improved balance between the economy's ability to produce and its ability to consume is essential in the months immediately ahead. The current lack of economic balance can be seen in recent trends of consumer buying power and productive capacity: Between 1955 and the end of 1958, the buying power of total after-tax personal income rose only 6.4 percent, compared with a 17-percent increase in industrial capacity. The rise in productive capacity was more than 2½ times greater than the increase in consumer buying power.

While total consumer buying power has increased at a snail's pace in recent years, the population has continued to grow. The buying power of per capita after-tax personal income, at the end of 1958, was less than it was in 1956. Our average living standards have actually been reduced in the past 3 years.

*Buying power of per capita after-tax personal income*

| | Annual rate in 1958 dollars |
|---|---|
| 1956—1st quarter | $1,823 |
| 2d quarter | 1,839 |
| 3d quarter | 1,828 |
| 4th quarter | 1,837 |
| 1957—1st quarter | 1,835 |
| 2d quarter | 1,844 |
| 3d quarter | 1,834 |
| 4th quarter | 1,809 |
| 1958—1st quarter | 1,773 |
| 2d quarter | 1,766 |
| 3d quarter | 1,795 |
| 4th quarter | 1,795 |

Seasonally adjusted yearly rates.

Source: Council of Economic Advisers.

A boost in consumer buying power is needed in 1959. It is unrealistic to expect a substantial rise in consumer spending—particularly for hard goods and homes—while the buying power of per capita after-tax income is less than it was more than 2 years ago.

Wage and salary increases and a reasonably stable price level are essential in 1959. With profits rising rapidly from the recession low point in recent months, there can be no rational reason why substantial wage and salary increases cannot be granted, without raising living costs.

The economy, obviously, cannot continue, as it has in the past 9 months, with almost half of the rise in gross national product going to corporate profits. Corporate profits dropped sharply during the general decline, but they have risen sharply with the upturn in production. Between the first quarter of 1958, the recession low point, and the final quarter of the year, corporate profits rose by a yearly rate of $12.3 billion, almost back to the prerecession level—accounting for 45 percent of the increase in gross national product. Should anything like this condition continue in 1959, the pickup from the recession will be rapidly undermined.

An improved balance is needed quickly between the economy's ability to produce and its ability to consume. Consumer buying power must be raised sufficiently in the months ahead to provide the basis for a substantial increase of consumer purchases of goods, services, and homes. Government policies must encourage balanced economic growth, rather than discourage expansion toward full employment and full production.

### THE ADMINISTRATION'S ASSUMPTIONS MEAN CONTINUING HIGH UNEMPLOYMENT

Current assumptions of the administration and business spokesmen are that the Nation's total output of goods and services will rise about 6 percent between the fourth quarter of 1958 and the same period of 1959. Unless definite steps are taken to encourage this increase, even a 6 percent rise may be too optimistic. But if we assume such a 6-percent increase, then, we are likewise assuming a continuation of high unemployment and idle productive capacity. The current assumptions of business and Government leaders about economic trends in 1959 bespeak pessimism and defeatism.

In the fourth quarter of 1958, the gross national product was at a yearly rate of $453 billion. Nonfarm employment in those final months of last year was 1.7 million less than when the recession started. The number of jobless was 3.9 million or 6.4 percent of the labor force.

A 6-percent rise in total output would bring the gross national product to $480 billion. If this rise represents the real volume of goods and services rather than any increase in the price level, it means that unemployment by the end of the year, we find, will still be high as 5 to 5½ percent of the labor force. It means that about 20 percent of industrial capacity will remain idle.

A rise in output is produced by some combination of increased employment, and increased output per man-hour, and coming out of a recession, by a pickup in working hours. How would a 6-percent rise in real national output affect these factors?

Productivity has been rising rapidly since early last year. If output continues to pick up in 1959, productivity can be expected to rise at a rapid pace. Even if the rate of productivity advance slows down during 1959, it is probable that output per man-hour in the fourth quarter of 1959 will be about 4 percent greater than in the final months of last year—approximately equal to the average yearly advance in output per man-hour during the 1947–56 decade. This would mean that about two-thirds of the expected increase in real national product would probably be accounted for by the rise in output per man-hour.

The remainder of the 6-percent rise in real total output would result from a pickup in working hours and employment. A 4-percent rise in productivity and a modest rise in working hours to prerecession levels would mean less than a 2-percent rise in jobs. If nonfarm wage and salary employment increases by 2 percent, however, that would mean a rise of 1 million jobs. Should it increase by as much as 3 percent, it would bring nonfarm wage and salary jobs up by only 1.5 million. It is probable, therefore, that even by the fourth quarter of 1959, nonfarm wage and salary employment may be somewhat less than when the recession started.

In the meantime, however, the labor force is expanding. Commissioner Clague, of the Bureau of Labor Statistics, told this committee that the labor force may grow by 1 million persons this year, following 2 years of very slow growth, which resulted from economic stagnation. Even if the labor force grows by only 800,000, serious unemployment will persist.

The assumption of merely a 6 percent increase in real national product, between the fourth quarter of 1958 and the final months of 1959, points to approximately 3 to 3½ million unemployed toward the end of this year—5 to 5½ percent of the labor force.

Since productive capacity is continuing to expand, as the labor force is continuing to grow, a 6-percent rise in real national output would leave about

20 percent of productive capacity idle toward the end of 1959, compared with 22 percent in the fourth quarter of last year.

A 6-percent rise in real national output from a full-employment level would represent a substantial gain. From the slack level of the end of 1958, however, a 6-percent increase in the volume of the Nation's total output is a very small improvement, indeed.

Furthermore, most observers do not expect a consistent rise in the output throughout the year. A higher rate of increase is generally expected in the first half of the year, as business expands its inventories, and a slower pace of increase in the second part of 1959, on the basis of current trends. A slowing down of the upturn in the second half of the year would carry over into 1960. It means a continuation of high unemployment and great amounts of idle capacity in the years ahead.

Joblessness at 5 to 5½ percent of the labor force is an improvement over 6.4 percent. Twenty percent of capacity idle is better than 22 percent. But these improvements, based on business and Government assumptions, are petty, compared to the size of the problem. They indicate the willingness of Government and business spokesmen to accept large-scale unemployment and idle capacity as an inescapable price of our free economy.

When the Employment Act of 1946 was adopted it expressed the will and the determination of the American people to reject the negative and defeatism concept that a free society could not deal rationally and effectively with the blind forces of the marketplaces. The act's passage reflected repudiation of the notion that unemployment is the price of a free economy. The Employment Act of 1946 charged the President with the responsibility of proposing to Congress and the people, programs and policies needed to achieve maximum employment, production, and purchasing power.

It was widely accepted by most people at the time the Employment Act was adopted that maximum employment in the American economy meant a minimum of joblessness at any particular time, representing seasonal layoffs and persons who are temporarily shifting from one job to another in a dynamic economy. This would mean an unemployment rate of 3 percent or less. Between 1953 and the present, however, the economy has operated at lower levels of manpower utilization—unemployment has been over 4 percent. The prospect for the period ahead, based on administration and business assumptions seems to be a still higher unemployment level—about 5 percent or more of the labor force jobless.

This picture of economic trends in the period ahead represents defeatism—a continuation of drift and the waste of idle manpower and productive capacity. It is a violation of the intent of the Employment Act. It is not responsive to our national needs in the middle of the 20th century. It shows total lack of comprehension of the enormous growth possibilities of the American economy.

## PRODUCTIVITY ADVANCES AT AN ACCELERATING PACE

The growth potential of any economy is the combined result of increases in its labor force and the rate at which productivity advances. In the past, many economists have conceived of productivity in the United States as increasing at a fixed average rate per year. It was recognized that due to a wide variety of causes there were inevitably changes in the rate of advance from year to year, but it was generally assumed that these changes would average out to a simple annual percentage—figures ranging from 2 to 2½ percent increase per year have been the most widely used.

Even on this assumption the rate of growth of our total production for the past 5 or 6 years has been less than the normal increase in productivity, although to create new jobs for the added numbers of workers entering the labor force, the rate of economic growth should exceed the rate of productivity advance. Each year, workers not only produce more with an average hour's work, but there are more workers available to help swell the flow of production.

The concept of a fixed average rate of productivity advance, however, does not accord with the facts. It has, in fact, been implicitly rejected for some years by many business executives on the basis of knowledge arising out of their own intimate experience with the facts of industrial life. Thus, for example, Harlow Curtice, then president of General Motors, said at the end of 1954:

"* * * our rate of technological advance is constantly accelerating, which means that every year we can build better cars and build cars better than we could build them before; and second, that the market for automobiles is expanding steadily."

Unfortunately General Motors' price-profit policies were not as forward-looking as their production policies, so that the market did not keep on expanding very long; but that was partly due to a failure of judgment in not adopting price policies which took into account this accelerating rate of technological advance.

In the same year, 1954, Henry Ford II, speaking in Cologne, Germany, to a group of industrialists and Government officials, said:

"Rising American living standards have always been closely tied to our increasing industrial productivity. And productivity does not necessarily depend upon abundant materials, upon large existing markets, or even upon prosperity. Our productivity has improved in bad times as well as good.

"In recent years, it has grown at an ever quicker pace * * *."

Recognition of technological acceleration has been expressed outside as well as inside the automobile industry. David Sarnoff, chairman of the Radio Corp. of America, stated in a pamphlet entitled "The Fabulous Future."

"The quantity of new powers and products and processes at man's disposal is important; but even more important is the increasing speed at which these things have come. It is not a case of continued increase but of continued acceleration of increase. We need only project the trend into the future to realize that we are merely on the threshold of the technological age."

The conclusion of industrial executives that the pace of technological advance is accelerating is supported by statistical analysis of long-term overall rates of productivity advance in the economy. In connection with automobile industry negotiations in 1958, technicians on the staff of the UAW made a careful statistical analysis of the rate of productivity advance in the past half century in the whole private economy. One of the important resutls of that analysis was the emergence of impressive evidence that productivity has tended to advance at an accelerating rate over time. The nature of this analysis is described in an appendix to this statement.

What the analysis showed was a definite trend toward speeding up of the rate of productivity advance, to the extent of something more than one-tenth of a percentage point every 2 years. While this rate of acceleration may seem small, what it has meant in practice is that the trend rate of productivity growth has speeded up from 0.9 percent per year in 1910 to 3.9 percent per year in 1956.

The latter figure of 3.9 percent corresponds with the same figure published in the Economic Report of the President, January 1958, as representing the average annual rate of productivity increase for the years 1947–56. Although the exact correspondence is coincidental, since one represents the trend at a single point and the other represents the average for a period, it was to be expected that the two figures should not be very far apart.

This is not the first discovery of a trend toward acceleration in the pace of productivity advance. For example, John Kendrick, of the National Bureau of Economic Research, who pioneered in the development of measures of productivity change in the national economy, wrote in a paper published by the Bureau in 1956:

"* * * One striking fact stands out: there has been a significant acceleration of productivity advance since the end of World War I as compared with the prior two decades. The acceleration is most pronounced in the output-capital ratio, but it is also unmistakable in the output-labor ratio."

Writing in Sales Management Magazine in November 1955 Prof. Sumner H. Slichter, of Harvard University, said:

"Let us sum up briefly the outlook for the next decade.

"In the first place, we can look forward with considerable confidence to a more rapid growth in productivity mainly because of the increasing scale of industrial research and the prospective improvement in the art of management."

While the statistical analysis indicates a persistent accelerating tendency over the past half century, the forces which have contributed to it over the past 20 years or so are most readily apparent. For example, as Slichter points out, ever-increasing amounts are being spent by Government, industry, and the universities on research and development which directly or indirectly stimulates the growth of productivity. Such expenditures increased from $900 million in 1941 to $8¼ billion in 1957.

Largely in consequence of this increased research, there have been in recent years a number of major breakthroughs in our technologies of production. They include important advances in automation, electronics, the use of plastics and other synthetic materials, new metals, the use of radioactive materials in industry and important beginnings in the use of atomic and solar energy.

Many of the new technologies are of particular significance, especially in terms of the probable continuing acceleration of productivity advance, because they have wide applicability. These are not inventions whose use is limited to a single process or even a single industry, but whole new technologies which can be applied in a wide variety of fields. In this respect they are comparable to the steam engine that gave birth to the first industrial revolution, or to the assembly line principle which opened the door to modern mass production methods.

It is also significant that today's technological revolution is spreading into new fields which in the past were relatively untouched; for example, the substantial penetration of automation into many fields of clerical activity. In a recent article John Kendrick, of the National Bureau of Economic Research, noted "the speeding up of technological advance applicable to service." He wrote:

"Since the service area now employs more than half our labor force, a further acceleration would mean a noticeably faster rate of productivity advance in the economy as a whole, assuming that the commodity-producing industries maintain their past rates of advance."

WIDE NEW POSSIBILITIES OPEN

This new understanding of the accelerating pace of productivity advance compels us to think in wholly new dimensions both as to our economic possibilities and our problems. For example:

1. It is apparent that a substantially faster rate of growth in our economy is possible than has been generally supposed.
2. This faster rate of growth also makes possible more rapid progress in eliminating poverty, increasing leisure through a progressive reduction of the workweek and raising living standards generally, in meeting our public needs and providing assistance to other lands.
3. Realization of our potential growth rate should minimize any danger of demand inflation, although it will not solve the problem of administered price inflation.
4. Continuation of this higher growth rate will give us new assurance of our ability to win our economic race with the Communist world.
5. Recognition of the magnitude of our potential growth rate gives us a new yardstick against which to measure the cost of our failure to achieve full employment and full production.
6. While a high rate of technological advance permits more rapid growth, we must also recognize that it makes more rapid growth essential, if increasing productivity is not merely to mean spreading unemployment. National economic policies must be framed with this in mind.

A FASTER GROWTH RATE IS POSSIBLE

As I have already indicated, the rate of growth of our economy must normally exceed the rate of productivity advance, because growth results not only from increasing productivity but from additions to the labor force as well. An annual productivity increase of 3.9 percent, should produce economic growth at a rate of about 5 percent. Many of us in the past have viewed this goal as one to be achieved only with considerable effort. The recent report issued by the Rockefeller Brothers Fund, "The Challenge to America," say for example:

"As was pointed out earlier, our growth trend in the long period from 1870 to 1930 worked out to 3 percent per annum. In the past decade we have been following a 4 percent per annum upward trend. This record of growth lends confidence to the view that, if we act effectively and purposefully, we may reasonably expect a continuation of a growth rate of 3 to 4 percent per year over the next decade and beyond. In fact, *a growth rate of 5 percent is possible if we realize fully our impressive opportunities for economic expansion.* If the problems of growth are formidable, we have also found the impetus of our economy enormous." [Emphasis added.]

What the new productivity figures mean in effect is that a growth rate of 5 percent can now be considered a normal expectation, with still higher goals possible if we make the fullest use of our potentialities. I do not wish for a moment to suggest that a growth rate of 5 percent can be achieved automatically, or that it can be expected to develop out of policies of the kind which have produced so many obstructions to growth during the past half decade. It can be achieved only if we exercise both vigor and vision, through programs and policies which look forward to the future, not back to the past. But given these essential qualities of leadership, a 5-percent growth rate should constitute part of our normal expectation of healthy economic development.

Regular achievement of a 5-percent growth rate will open wide many doors to social progress which up to now have only with difficulty been kept from slamming shut. The Rockefeller Fund report put the problem in these terms:

"These projections also emphasize the fact that the high and rising level of defense expenditures is a major factor in holding back our progress on other more constructive fronts. We can afford the defense programs essential for survival. In doing so, however, *unless we achieve a 5-percent growth rate, we shall have to hold back otherwise desirable expenditures in the Government field and keep the growth of private expenditures below a level commensurate with our aspirations.*" [Emphasis added.]

In other words the rate of growth in our economy, after allowing for the needs of a growing population, represents the margin by which we have more for all purposes each year than we had the year before, the margin available for social progress. If we are faced with the necessity of high defense expenditures, then this 5-percent rate of growth must be made to meet all our needs. The Rockefeller Fund report suggests that a 5-percent growth rate is essential if we are to make the progress to which we aspire.

Even without the element of continuing acceleration, the cumulative effect of a 5-percent growth rate is most impressive. It means that we can virtually double our production of goods and services every 14 years. By achieving that goal we can rapidly eliminate poverty from this country, provide a constantly rising living standard with increased leisure for all, catch up rapidly with our unmet needs in such fields as schools, hospitals, homes, highways, and resource development, and at the same time make a contribution worthy of the world's wealthiest country to the economic development of those in economcally less advanced countries.

WE CAN WIN THE ECONOMIC RACE

Earlier I indicated that if the economies of the United States and the Soviet Union both continue to grow at the respective rates at which they have been growing since 1950, it will be only another 17 or 18 years until the gross national product of the Soviet Union will exceed our own. That statement was based on estimates made by Allen Dulles, Director of the Central Intelligence Agency, with respect to the rate of economic growth in the Soviet Union, together with the latest available data as to our own rate of growth.

On April 29, 1958, Mr. Dulles told the 46th annual meeting of the U.S. Chamber of Commerce:

"Whereas Soviet gross national product was about 33 percent that of the United States in 1950, by 1956 it had increased to about 40 percent, and by 1962 it may be about 50 percent of our own. *This means that the Soviet economy has been growing, and is expected to continue to grow through 1962, at a rate roughly twice that of the economy of the United States.*" [Emphasis added.]

Since that time the Soviet Union has claimed to have achieved an even higher rate of growth. The rate implied by Mr. Dulles' figures would come to about 7 percent per year. On January 27, 1959, Premier Khrushchev told the Communist Party Congress that during the next 7 years the Soviet economy would continue to grow at a rate of about 8.6 percent per year, on which a New York Times analyst commented, "Judging from recent performance, he may not be far wrong," and contrasted it with a rate of growth in this country since the end of the Korean war of less than 1.5 percent per year.

Taking into account the possibility that Mr. Khrushchev may have raised his figures a bit for purposes of both domestic and international propaganda, it would seem that Mr. Dulles' estimates are worth consideration as a reasonable and realistic forecast.

At the same time, as a result of the recession, even the modest rate of growth which the U.S. economy averaged between 1950 and 1956 has not been maintained. Between 1956 and 1958 it failed to grow at all. As a result, the average annual rate of growth between 1950 and 1958 comes to only about 2.8 percent per year.

If the respective rates of growth of the American and Soviet economies are projected forward, it becomes ominously apparent how significant these differences are. In spite of the fact that U.S. total production is still probably a little more than double that of the Soviet Union, if they had both continued to grow at the same rate between 1950 and 1956, the Russians would have caught up with us by about 1985.

However, if you assume further repetitions of our current recession, and project future growth of the U.S. economy at the still lower rate which represents the annual average for the period 1950–58, the Soviets will have matched and surpassed us by 1977. This, to me, is dangerously close. It means that unless America provides the dynamic leadership and the effective implementation of bold programs to reverse this trend, the margin of survival between the forces of freedom and of tyranny may soon be reduced to the point of disaster.

Our position would be far less disquieting if we achieve, as we can and should, the 5-percent annual growth rate that is within our power even if we make no allowance for continued acceleration of the rate of productivity advance.

With the Soviets expanding their economy at an assumed rate of 7 percent per year they would still catch up with us eventually—in terms of total although not per capita output. But the date would be postponed until about 1996, rather than 1977.

Within that period of time many things can happen, including even the possibility that internal changes in the Soviet Union may help to create a better international climate in which it may be possible for our two nations to live together peaceably in one world.

In any case, the achievement of a 5-percent growth rate in our economy would give us many precious years of additional time in which to find our answers to the problem of world peace, without having to face the additional problems certain to be thrown at us by a regimented, hostile Soviet economy which had grown greater and more powerful than our own.

### FAILURE TO ACHIEVE OUR POTENTIAL HAS COST US DEARLY

Our economy suffered a recession in 1953–54 and another in 1957–58, with only a partial recovery in between. If instead we had maintained full production, full employment, and full utilization of our technological skills, with a steady growth of production at the annual rate of 5 percent which we could have achieved under those circumstances, the total value of goods and services we would have produced over that period, expressed in dollars of 1958 buying power, would have been approximately $212 billion greater than it actually was.

That is the measure of the loss we have suffered—$212 billion worth of food, clothing, homes, household goods, schools, hospitals, factories, power dams, economic aid, and all the other goods, services, and facilities that would have helped create abundance.

If we had maintained that rate of growth since 1953, our national production in 1958 alone would have been about $525 billion, or $88 billion more than it actually was—sufficient to have allowed an increase of 20 percent in every item of expenditures, public and private. This we could have divided among personal and family spending, health, education, and other Government services, national defense, help to our friends in other lands and new plants and equipment to meet our future growing needs.

### WE CAN ACHIEVE A STABLE PRICE LEVEL

The problem of a rising price level has been used by antilabor propagandists to attack the American system of collective bargaining and by conservatives, generally, as an argument for restrictive economic policies and cuts in Federal programs. They are dangerously wrong and the policies they suggest would be disastrous.

The creeping price rises between mid-1955 and mid-1958 were due to a number of factors, including: the ability of giant corporations in key industries to raise prices despite declining sales, business and Government policies that raised industrial costs, crop and weather conditions that affected food prices, and continuing increases in the demand for services that are related to population growth, improved living standards, changing patterns of consumer demand, and the spread of suburban living.

The claim has been loudly made that members of large unions have benefited from a rising price level at the expense of other elements in the community and especially stockholders, who invest their money in the companies. This charge is belied by the facts as they relate to leading corporations in administered price industries. When we look at the General Motors record, for example, we find that stockholders' gains have been several times greater than those of the General Motors worker.

An investor who, at the beginning of 1947, purchased 1,003 shares of General Motors common stock would have received $3,009 in dividends in 1947—exactly the same as the earnings in that year of the average General Motors worker if he were fully employed, 52 weeks, without layoff, which is an overestimate of earnings.

Starting with the same annual income in 1947—one as the reward for his work and the other as return on his investment—the stockholder's income from dividends would have risen more than twice as fast as the worker's income from wages. By the end of the third quarter of 1958, after 11¾ years, the worker would have received in pay checks a total of $51,458, and the shareholder would have received in dividends a total of $107,822, or 109.5 percent more than the worker.

But that is only part of the story. As dividends grew, the corporation's retained earnings increased and the market value of the stockholder's shares also increased, a capital gain he can realize at any time. Based on the average market value of General Motors common stock on the first day of business in 1947, the shareholder's 1,003 shares would have cost him $52,846. By September 30, 1958, as a result of 2 stock splits, these 1,003 shares would have become 6,018 shares, worth about $48 per share, or $288,864. If the shareholder sold his stock at this price, he would have enjoyed a capital gain of $236,018. Added to his $107,822 in dividends, this would have given him a total benefit from his stock ownership of $343,840—nearly seven times as much as the General Motors worker's earnings from his labor during the same period.

The same facts can be put in another way. If the stockholder in 1947 had invested only $7,909, he would have received, in dividends and eventual capital gain, the same amount as the worker earned. In other words, a worker's sweat and toil and the investment of almost 12 years of his life produced for him the same return as an investment of 7,909 in cash.

This illustration merely points to the utter lack of fact or justice in the barrage of antilabor attacks on American workers as the instigators and beneficiaries of price rises. It also points to one of the Nation's important social and economic problems—the ability of key industries, whose prices are administered by huge corporations, to raise prices and cut break-even points to 50 percent or less of capacity to produce.

The record since mid-1955 clearly indicates the power of industries such as steel, auto, and oil refining to protect their markets from price competition. Prices in such key industries are established by the executives of the dominant corporations to produce high rates of return on investment.

The Senate Antitrust and Monopoly Subcommittee report on automobile industry pricing states the following concerning General Motors, the industry's dominant corporation:

"In the past 10 years, 1948–57, the company's average annual return, after taxes, on its stockholders' investment has been an impressive 25 percent. In the worst of these years, 1957, the rate of return on average stockholders' investment was over 17 percent, a figure which any public utility would regard with some awe. At the other extreme, the company was able to earn a return of 37.5 percent in 1950, an exceptionally good year."

The facts brought out by the subcommittee clearly indicate that it was the quest for these very high profits, rather than wage demands on the part of labor, that were primarily responsible for rising auto prices. In its findings the subcommittee reported:

"* * * it is hard the escape the conclusion that prices and unit profits have risen much more rapidly than unit costs in the past two decades."

The same Senate committee investigated the pricing policies of the basic steel industry and found that "the break-even point for both the steel industry as a whole and the United States Steel Corp. individually is * * * slightly below an operating rate of 40 percent. This is to say, the industry and the corporation tend to move out of the red into the black when production, as a percent of capacity, reaches a level of just under 40 percent."

This means that the dominant United States Steel Corp. and the steel industry generally have succeeded in raising prices to the point where they can still make profits with over 50 percent of their plants and machines idle. In the first half of 1958, for example, United States Steel earned $271.65 million before taxes and $135.65 million in after-tax profits, when operating at less than 54 percent of capacity.

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If we are to make any serious effort to achieve a relatively stable price level, we must attempt to find a solution to this problem. Some way must be found to curb the price-raising ability of giant corporations in key industries, in which there is no effective price competition.

Any serious attempt to achieve a reasonably stable price level must also, I believe, be based on a rapid rate of economic growth. Rapidly rising total output makes possible rapid increases in productivity and lower production costs. It also makes possible a large supply of goods and eases the pressures among competing social and economic groups—it is considerably easier to solve the problems of who is to receive what share of the net product if the pie is great, than if it is small.

In addition, it would be well for the Government to assist in the development of methods to increase productivity and reduce costs, particularly in those parts of the economy, such as the services, where the great possibilities that exist for improvement in productivity can be realized more rapidly through organized effort. In the low wage service industries, the stimulus that wage increases provide for increasing efficiency can be aided by a rise in the Federal minimum wage and extension of the law's coverage.

A reasonably stable price level can be achieved. But it can be achieved only if the propaganda warfare ceases and the realities are squarely faced. A rapidly growing economy is needed to provide the general environment for relative price stability. Special problems, such as the price-raising ability of the giant corporations in key industries, must be solved on the basis of the obvious facts.

What is needed in this area is less heat and propaganda and more light on the economic facts. Congress should make a comprehensive study of the administered price problem in an effort to find an effective and rational way of protecting American consumers and the American economy from the inflationary pressures created by the pricing policies of a few giant corporations in critical sectors of the American economy.

During the recent hearings of the Senate Antitrust and Monopoly Subcommittee, I proposed for my own union, the UAW, that any company which controls, say, more than 20 or 25 percent of the sales in its industry be required to give advance notice and public justification of price increases it proposes to put into effect, through a public hearing before a Government agency which would have access to all the relevant data, and after the hearing would publish the facts as they had been brought out.

In a free society an enlightened public can create the moral pressures essential to make private economic decisions publicly responsible. As I said before the subcommittee, "In a democratic society, there is always everything to be gained, and never anything to be lost, by giving the people the facts they need in order to make their judgment of the conduct of those whose decisions affect the life and welfare of every man and woman."

### ECONOMIC POLICIES FOR FULL EMPLOYMENT AND ECONOMIC GROWTH

There is urgent need for a decisive change in economic policies. Instead of drift and stagnation, we need leadership and a clear statement of goals that are responsive to national requirements in a time of population growth, rapid technological change, cold war, and the economic aspirations of peoples emerging from colonial dependency to national independence.

We have followed a national policy of drift so long, and our economy has stagnated for so many years, that we cannot hope to fulfill unmet national needs in a few months or even years. We can and should, however, make a beginning immediately and start to meet our needs.

There is urgent need for setting forth a program of national priorities in which we begin to put first things first and commit our resources to the achievement of those national priorities.

The requirement at the present is to begin to move rapidly and decisively toward an expanding full-employment economy. There is no single pattern for this achievement. A number of steps are essential.

In particular, a decisive change in attitude and direction is needed in regard to Federal expenditures and programs. The major test as to whether or not they are worthwhile should not be cost or budget balancing, but their need. National needs must be met, in the light of the requirements of the middle of the 20th century.

A PROGRAM TO GET AMERICA BACK TO WORK

1. *Distressed areas.*—Federal Government assistance for economically distressed communities is essential. The experience of recent years clearly indicates that the changing location of industry and the decline of some industries leave pockets of unemployment, even when most of the Nation is fairly prosperous. This problem has grown in size and seriousness, not only because of the recession, but also because of automation and rapid technological change. There is substantial unemployment at present in more than half of the Nation's major industrial centers and in 183 smaller labor markets, with the probability that the current economic distress represents a hard-core, chronic condition in many if not most of them. A concerted program of Federal Government aid, through loans and grants, is urgently needed to aid these communities to bring in new industries, to retain workers, and to assist workers to move to new communities where jobs are available.

2. *Minimum Federal standards for unemployment insurance.*—The unemployment insurance system should be permanently improved by additional Federal standards to extend duration and raise benefit payments to unemployed workers. Harsh disqualification provisions should also be removed. As the President's "Economic Report" recognizes, the unemployment insurance system has proven its great, but limited, effectiveness in offsetting economic declines. The system should be strengthened and improved.

3. *Community facilities.*—Many communities would be happy to relieve local unemployment and at the same time create new or improved facilities for education, health, recreation, police and fire protection, civil defense, parking, or other public needs, if they had the necessary means. Amendments to the Housing Act in 1955 did establish a $100 million revolving fund to provide loans for construction of water, gas, and sewer systems, but the scope of this measure is far too restricted and the funds entirely inadequate. Congress should pass new community facilities legislation which would provide authority and funds to assist municipalities in the provisions of a wide variety of necessary facilities.

4. *Government contracts for distressed communities.*—One of the most obvious ways in which the Federal Government can give immediate aid to communities distressed with serious unemployment is by placing defense and other Government contracts in such areas. For some years now the administration has given lipservice to this principle, but in practice little has been done except to give some priority to such areas when all other procurement considerations are equal. This is not enough. Government procurement policies should be based on the principle that reasonable additional costs involved in placing contracts in distressed areas will be offset by resulting avoidance of the heavy financial costs and other tragic consequencies of unemployment, both to such communities and to the Nation.

5. *Minimum wage.*—Congress should extend the coverage of the Fair Labor Standards Act to millions of workers in trade and services, and should raise the minimum wage under the act from the present $1 to $1.25 an hour. Such action would not only aid in increasing consumer buying power, it would also be a step toward eliminating poverty from the American scene.

6. *Social security.*—The Social Security Act should be improved through increased benefits, liberalized eligibility, and medical-care provisions for those receiving social security benefits.

7. *Commission on technological change.*—We must devise social and economic programs to cushion the dislocations that result from automation and rapid technological change. For several years, now, we have been living through a silent revolution in the United States—a revolutionary change in production and distribution processes, manpower requirements, composition of the work force, and location of industry. This silent revolution is continuing and, in the not-too-distant future, there will be the widespread introduction of nuclear energy for peacetime uses, with the possibility of a vast impact on the location of industry, on opportunities for employment, and on the skills of the labor force.

It is irrational to move blindly, without direction or information, through a period of radical technological change. Information is needed to help guide Government and private groups in devising policies that can minimize social and economic dislocations.

This committee of the Congress has made a start in this direction. Much more information and examination of varying policy proposals are needed. A permanent National Commission on Technological Change should be established to investigate and keep abreast of these important issues. Such a National Commission should be composed of representatives of labor, farmers, management, consumers, and Government. It should keep under continuing review developments in automation, atomic and solar energy, and other technological innovations, and make recommendations to Congress and the President to assure that the fruits of technological advance are fairly shared and full employment sustained.

8. *Progressive reduction of the workweek.*—The Fair Labor Standards Act should be amended to provide for a progressive reduction of the standard workweek, with provision for periodic review by the proposed National Commission on Technological Change to that, as our technology continues to advance, workers can enjoy through a shorter workweek an increasing measure of creative and purposeful leisure instead of suffering the tragic and wasteful idleness of unemployment.

Historically, we in America have always taken part of the fruits of advancing technology in the form of reductions of working hours, while at the same time increasing our supply of goods and services. The accelerating rate of productivity advance makes it possible to progress faster in both respects.

The rate of reduction of the standard workweek should take into account both the rate of technological advance and the extent to which our growing power to produce is actually being used to raise living standards, to meet our national needs for more and improved homes, schools, hospitals, highways, resource development, etc., and to provide for generous international economic aid and an adequate defense. When workers are unemployed, or suffering short workweeks, or faced with the threat of unemployment, they can scarcely be asked to accept the argument that a 40-hour week is needed to attain our national objectives while their Government takes no steps to assure that their available working hours are fully utilized.

9. *Aid to education.*—There is a growing need for Federal aid for education to strengthen the basic human resources of our country. This should mean, not only aid for school construction, but also a Federal scholarship program.

10. *Housing.*—A national housing program is needed to provide good homes in decent neighborhoods for all American families. The program should provide adequately for public housing for low-income families, slum clearance, and urban redevelopment, and low-interest, long-term mortgages for privately constructed moderate-priced homes and apartment developments. In this connection, too, a Federal loan program for the improvement of community facilities is needed.

11. *Hospitals, highways, resource development.*—Other essential Federal programs include hospitals and other medical facilities, highways, and natural resource conservation and development. These, and similar programs to strengthen our human resources and to promote more efficient use of our material resources, contribute to full employment, facilitate economic growth, and add to national security in a troubled world.

12. *Adequate defense.*—The national defense effort is in need of careful examination in terms of the military requirements for the defense of freedom. The U.S. lag behind the Russians in some areas is obvious even to a layman. Informed experts have challenged the adequacy of the President's defense budget proposals. Defense expenditures should be stepped up wherever necessary to meet our national security needs.

13. *Economic aid.*—Economic and technical aid for the peoples that are emerging from colonialism should be considered as a major aspect of national policy. Such programs of loans and grants, both directly and through international agencies, should be greatly expanded as a part of a long-term effort by the United States to assist the economically underdeveloped nations.

14. *Consumer buying power.*—Consumer buying power must be raised substantially in order to lift sales and output in the months ahead. Wage and salary increases, and a reasonably stable price level, therefore, are essential. The President and the Congress should declare their essentiality as part of a concerted effort to eliminate the waste of idle manpower and machines.

15. *Tight money.*—The Government should indicate its support for a policy of rapid economic growth to full employment and full production by halting the tight money policy which is generally restrictive. Instead of attempting to restrain the entire economy while over 6 percent of the labor force is unemployed because prices in one economic sector, the stock market, have risen, the Government should use specific measures to curb excessive stock market specu-

lation. A step in this direction would be the effective enforcement of the elimination of margins on all stock purchases.

16. *International trade.*—International economic and trade policies of the United States likewise require bold and realistic measures to meet the needs of the times. Vice President Nixon's experience last year in South America dramatized, for example, the need to move in the direction of stabilizing raw material prices on an international basis.

17. *International fair labor standards.*—The United States must build its trade relations with other countries, particularly since we need a wide variety of imports as well as foreign markets. But we cannot avoid the problem of unfair competition with some American products from low-wage, highly efficient foreign producers. In this connection, the United States should propose, through the International Labor Organization, the creation of international fair labor standards provisions on wages and other labor conditions in export industries directed at raising wages in such industries, step by step, to levels justified by productivity. This would bring to an end unfair international competition based entirely on depriving workers of their fair share of the fruits of their labor.

18. Fair employment practices.—Opportunities should be opened for members of minority groups to contribute fully to and share fairly in social and economic growth through enactment of Federal fair employment practices legislation.

19. Meeting the cost.—Admittedly, not all of these programs can be gotten underway in time to affect the level of economic activities in 1959. But their initiation now would change the direction and tone from defeatism to optimistic faith in the ability of the national economy to move forward in response to the needs of our times.

We have been told often—and it will be repeated in the future—that this Nation cannot afford to meet both the defense and public service needs of the middle of the 20th century. The truth is, first, that under aggressive leadership the means at hand are ample not only to meet our needs in both areas but also sufficient to make up rapidly for time already lost in meeting them; and, second, that what we can afford least of all is to fail to meet them.

A more rapid rate of economic growth—higher employment and increased utilization of productive capacity—will, in itself, generate personal and business incomes and Federal revenues. A large part of the increased expenditures for expanded Government programs can arise from an increased rate of economic growth.

Still more additional Federal revenues are available, without raising tax rates, by closing current loopholes in the tax structure. As much as $9 billion in additional revenue can be raised if these numerous loopholes were closed. Certain immediate steps in this direction would raise about one-third of that amount of additional revenue by closing the following loopholes of special privilege for wealthy families and corporations. To gain this much revenue we need merely—

(*a*) Repeal the favored tax treatment granted to dividend income from stocks by the Revenue Act of 1954.

(*b*) Require withholding taxes on the payment of dividends and interest, similar to the present system of withholding taxes on wages and salaries.

(*c*) Repeal excessive depletion allowances such as those for oil and gas and remove such tax privileges from many of the metals and minerals now covered.

(*d*) Tighten the capital gains structure by lengthening the holding period for long-range gains and increasing the current 25-percent tax rate.

(*e*) Remove from capital gains treatment the many types of income not originally included.

Full employment, a more rapid rate of economic growth, and steps toward closing the numerous tax loopholes can raise more than enough revenue to cover the increased Federal expenditures to meet our national needs.

* * * * * * *

Above all, this Nation needs leadership and direction to move out of stagnating, rudderless drift into a firm faith in the future of our free society. We have the human resources, skills, and ingenuity. We have the productive equipment. What we need is a decisive change in national policies that are firmly rooted in an optimistic conviction about our Nation's ability to grow and to solve its many problems.

History has thrust world responsibility upon America and we have become the custodians of human freedom. No nation is better equipped to meet these new and challenging responsibilities, for we are blessed with tremendous economic and human resources and a great democratic heritage.

The American economy is the most productive in the world. It is freedom's greatest material asset and if its potential abundance is fully mobilized and intelligently and responsibly distributed, it is equal to the challenge we face.

We must reject the counsel of the men of little faith who would sell America short by preventing the realization of the full growth and the maximum potential of the American economy. As a people and as a nation we must act in the knowledge that we are engaged in a struggle for peace and our very survival, and that the challenge of peace is equally compelling and costly but more complex than the challenge of war.

The American people and the American economy responded to affirmative leadership following Pearl Harbor. The challenge today is no less imperative and the American people and the American economy will once again respond to bold and imaginative leadership.

We cannot hope to overcome our fiscal deficit until we first overcome our leadership deficit. We need bold leadership and direction to move out economic stagnation and drift. We need leadership with a firm faith in the future of our free society that can call into play our great human resources and skill and our ingenuity and our productive capacity.

We need decisive changes in our national policies that are firmly rooted in the conviction that our Nation has the ability and the capacity to grow and expand and find answers to these challenging problems.

We need first of all to overcome the crippling and corrupting influence of complacency.

We need to comprehend more fully the dimensions of the Soviet challenge and the totality of the threat with which we are confronted.

I share the concern expressed by Gen. Omar Bradley when he said: "I am sometimes discouraged not by the magnitude of the problem but our colossal indifference to it."

As a people and as a nation we need to get our values in sharper focus. We need to think through together the values that we are defending and trying to extend in the world.

We need a list of national priorities for peace and survival, and we need the will to commit our resources, both human and material, in total effort to achieve these national priorities. We have to put first things first so that we do not dissipate our time, our energies, and our resources.

We need to recognize that new problems and new challenges will require new concepts and new approaches, and we need to dare to try such new concepts and new approaches, for we cannot solve tomorrow's problems with yesterday's tools.

We need above all a sense of national urgency out of which we can achieve the same measure of national unity and singleness of purpose to win the peace that we demonstrated in winning the war.

We must recognize that business as usual, whether in government, industry, or labor, will not make us equal to the challenge before us.

I have unlimited faith in the capacity of freemen to win over those who slave under systems of tyranny. In the words of Abraham Lincoln, "If we could first know where we are, and whither we are tending, we could then better judge what to do and how to do it."

## Appendix

### Measuring the Accelerating Productivity Trend

The tendency of productivity in the United States to advance at an accelerating rather than a constant rate has long been recognized by many economists as well as by corporate executives familiar at first hand with the facts of industrial life.[1]

Nevertheless, those who have attempted statistical measurement of the productivity trend have generally assumed that the annual percentage rate of advance is constant. One noteworthy exception is J. Frederic Dewhurst who,

[1] A few examples of expressions of such recognition appear in the main body of this statement.

in the Twentieth Century Fund study entitled "America's Needs and Resources," presented computations showing a long-term tendency for productivity to advance at an increasing rate.[2]

The assumption of a constant rate of productivity advance predetermines the results of those statisticians who accept it. They compute their trend lines on the basis of first degree least squares logarithmic equations. Such equations, by their very nature, would not show acceleration no matter how strong the aceleration might actually be in the underlying data. Trend lines computed on the basis of such equations, when plotted on semilogarithmic paper necessarily yield straight lines reflecting what they assume—a constant annual percentage rate of change.

The resources of statistical science, however, provide a wide variety of trend equations from among which the statistician may choose, depending upon the nature of the data involved. While the choice of a trend equation frequently confronts the statistician with difficult problems, the standard statistics textbooks do present certain objective tests which he may summon to his aid.[3]

For purposes of measurement of the productivity trend, it is readily apparent from examination of the long-term data that the choice lies between a first-degree logarithmic least squares equation (the equation most commonly used) and a second-degree equation of the same type (the equation used by Dr. Dewhurst).

The second-degree equation would reflect acceleration if it is present in the underlying data. But, where there is no significant acceleration in the data, the trend line plotted on the basis of the second degree equation will tend to approach a straight line, i.e., will tend to take approximately the same form as the line computed from the first-degree equation.

The objective test for choosing between these two types of equations consists of smoothing the data and comparing the first differences of the logarithms with the second differences. As stated in one of the standard texts:

"If the first differences of the logarithms are constant, use an exponential. (Fit a straight line to the logarithms.)

"If the second differences of the logarithms are constant, fit a second-degree curve to the logarithms."[4]

The data used in the UAW computations presented in 1958 negotiations consisted of the productivity indexes prepared by the Joint Economic Committee's staff for the years 1909–37 linked to Bureau of Labor Statistics indexes for the years 1937–47 and to the indexes presented in President Eisenhower's "1958 Economic Report" for the years 1947–56.[5]

When these data were smoothed with moving averages, the first differences showed a marked tendency to increase from year to year. In fact, they were roughly twice as great toward the end of the period covered by the moving averages as they were at the beginning. The second differences, on the other hand, fluctuated within a relatively narrow range, i.e., they tended to approach constancy.

Thus the objective tests indicated the use of the second degree equation. This finding was supported by examination of the index numbers for the indi-

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[2] Dewhurst's results are somewhat different from those described in this statement, although his method is the same, because he used different data for a different period. His calculations are based on national income estimates for every 10th year starting with 1850. Thus his trend equation is based on 11 points in all and the data for the earlier years in particular are subject to substantial margins of error. The calculations here presented are based on better data (the productivity estimates, based on private gross national product, of the staff of the Congressional Joint Economic Committee for the years 1909 through 1937 and the BLS estimates thereafter) for all years from 1909 through 1956 except the war years 1941–46 for which BLS has published no figures.

[3] See, for example, Frederick C. Mills, "Statistical Methods Applied to Economics and Business," revised edition (Henry Holt & Co., 1938), pp. 274ff.; and Frederick E. Croxton and Dudley J. Cowden, "Applied General Statistics" (Prentice-Hall, Inc., 1939), p. 461 f.

[4] Croxton and Cowden, op. cit., p. 462. The texts also indicate that in the analysis of economic data these tests will rarely, if ever, be met perfectly. See, for example, Mills, op. cit., p. 276.

[5] The Joint Economic Committee indexes are from "Productivity Prices and Incomes," p. 89; and the BLS indexes, from "Postwar Productivity Growth in the United States"; the indexes drawn from the President's "Economic Report" are those which measure productivity in terms of hours worked and where also computed by BLS. Splicing these indexes is proper because all of them are based on the man-hours worked concept. The BLS indexes were used for the period since 1937 because the man-hours' data on which they are based are clearly superior to those used by the staff of the Joint Economic Committee. There were no BLS indexes, however, for the war years 1941–46 and these years, therefore, were omitted from the computations. The analysis stopped with the year 1956 since at the time the trend was computed only a preliminary index was available for 1957.

vidual years of the period covered, plotted as points on a semilogarithmic chart.[6] The points clearly tended to follow a curve rather than a straight line.

In fact, a trend line computed on the basis of a first degree equation highlighted the curvilinear nature of the data by revealing that the plotted points representing the actual indexes were above the line for all of the earliest as well as for all of the most recent years of the 1909–56 period. The straight line was seen to rise much more steeply than the points in the early years, indicating that the first degree equation oversttaed the actual rate of increase in those years, while, in the later years, the points rose much more steeply than the line, indicating that the first degree equation understated the actual rate of increase in those years.

Statisticians would attach particular significance to one other indication that the second degree trend line fits the data better than the first degree. That is the fact that the deviations of the logarithms of the actual index numbers for individual years from the logarithms of the index numbers computed on the basis of the equations approximate a normal distribution in the case of the second degree equation but not in the case of the other.

Since the productivity indexes for the earlier years of the 1909–56 period are less reliable than the indexes for later years because of the inadequacies of the basic data from which they are computed, an additional test was applied to determine whether differences in the reliability of the indexes for different periods might have influenced the trend rate of growth derived from the second degree equation for the entire period. Second degree trends were computed for periods beginning respectively with 1919 and 1935[7] and ending, in both cases, with 1956.

Both yielded computed rates of productivity advance for 1955–56 remarkably clase to the 3.9 percent computed on the basis of the entire period 1909–56. The computed 1955–56 rates were 4.1 percent based on the period 1919–56, and 4.0 percent based on the period 1935–56.

A comparison of the actual annual indexes of productivity with those computed on the basis of the second degree equation is presented in the attached table which also shows the equation. The close correspondence between the actual and computed indexes is readily apparent. Substantial deviations of the actual from the computed indexes appear for only three periods—the World War I years, the 1920's, and the great depression. The direction of the deviations in each of these cases is that which would be expected. The actual are below the computed indexes during World War I and the depression. The actual are above the computed indexes during the prosperous twenties.

The rise of the actual indexes above the trend line during the 1920's, coupled with similar though smaller deviations during the first half of the present decade, reflect the fact that productivity growth is facilitated under conditions of relatively full employment. These deviations strongly suggest that the trend rate of productivity advance computed on the basis of a half century's experience that includes wars, depressions, repeated recessions, and periods of economic stagnation is an understatement of the rate that would be attained under conditions of continuing full employment.

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[6] Such examination is one of the methods which the texts suggest for choice of a trend equation. See, for example, Croston and Cowden, op. cit., p. 462.

[7] These years were selected as starting points because their respective productivity indexes indicated a return to something approximating "normal" situations after periods during which productivity had been depressed in World War I, in the first instance, and in the great depression, in the other.

In addition, there is strong reason to believe that the productivity indexes understate our actual, experienced rate of productivity advance. Statisticians are still wrestling with certain defects in the data and methods used to measure productivity. While these defects lead to errors in both directions, those tending to bias the productivity indexes in an upward direction are few and have negligible effect. A greater number of the known defects tend to cause downward bias, in several cases to a significant extent.

*Output per man-hour in the total private economy, 1909–56*

[Comparison of actual and computed indexes (with actual index for 1947=100)]

| Year | Actual index [1] | Computed index [2] | | Year | Actual index [1] | Computed index [2] | |
|---|---|---|---|---|---|---|---|
| | | Annual | Percent change from preceding year [3] | | | Annual | Percent change from preceding year [3] |
| 1909 | 46.7 | 46.8 | ---------- | 1933 | 61.1 | 68.8 | 2.4 |
| 1910 | 46.7 | 47.2 | 0.9 | 1934 | 66.8 | 70.5 | 2.4 |
| 1911 | 48.3 | 47.6 | .9 | 1935 | 71.7 | 72.2 | 2.5 |
| 1912 | 50.0 | 48.1 | 1.0 | 1936 | 73.7 | 74.1 | 2.6 |
| 1913 | 50.0 | 48.6 | 1.1 | 1937 | 75.8 | 76.0 | 2.6 |
| 1914 | 49.4 | 49.2 | 1.1 | 1938 | 76.6 | 78.1 | 2.7 |
| 1915 | 48.5 | 49.8 | 1.2 | 1939 | 80.0 | 80.2 | 2.8 |
| 1916 | 49.7 | 50.4 | 1.3 | 1940 | 84.5 | 82.5 | 2.8 |
| 1917 | 45.8 | 51.1 | 1.3 | 1941 | ---------- | 84.8 | 2.9 |
| 1918 | 47.0 | 51.8 | 1.4 | 1942 | ---------- | 87.3 | 2.9 |
| 1919 | 52.7 | 52.6 | 1.4 | 1943 | ---------- | 90.0 | 3.0 |
| 1920 | 51.6 | 53.4 | 1.5 | 1944 | ---------- | 92.7 | 3.1 |
| 1921 | 53.3 | 54.2 | 1.6 | 1945 | ---------- | 95.7 | 3.2 |
| 1922 | 57.1 | 55.1 | 1.7 | 1946 | ---------- | 98.7 | 3.2 |
| 1923 | 59.3 | 56.1 | 1.7 | 1947 | 100.0 | 102.0 | 3.3 |
| 1924 | 61.0 | 57.1 | 1.8 | 1948 | 104.2 | 105.3 | 3.3 |
| 1925 | 63.6 | 58.1 | 1.8 | 1949 | 105.4 | 108.9 | 3.4 |
| 1926 | 64.5 | 59.2 | 1.9 | 1950 | 114.5 | 112.7 | 3.5 |
| 1927 | 64.6 | 60.4 | 2.0 | 1951 | 118.8 | 116.7 | 3.5 |
| 1928 | 64.2 | 61.6 | 2.0 | 1952 | 123.2 | 120.9 | 3.6 |
| 1929 | 65.5 | 62.9 | 2.1 | 1953 | 127.8 | 125.3 | 3.7 |
| 1930 | 63.6 | 64.3 | 2.2 | 1954 | 131.5 | 130.0 | 3.7 |
| 1931 | 65.4 | 65.7 | 2.2 | 1955 | 136.3 | 134.9 | 3.8 |
| 1932 | 62.6 | 67.2 | 2.3 | 1956 | 137.9 | 140.2 | 3.9 |

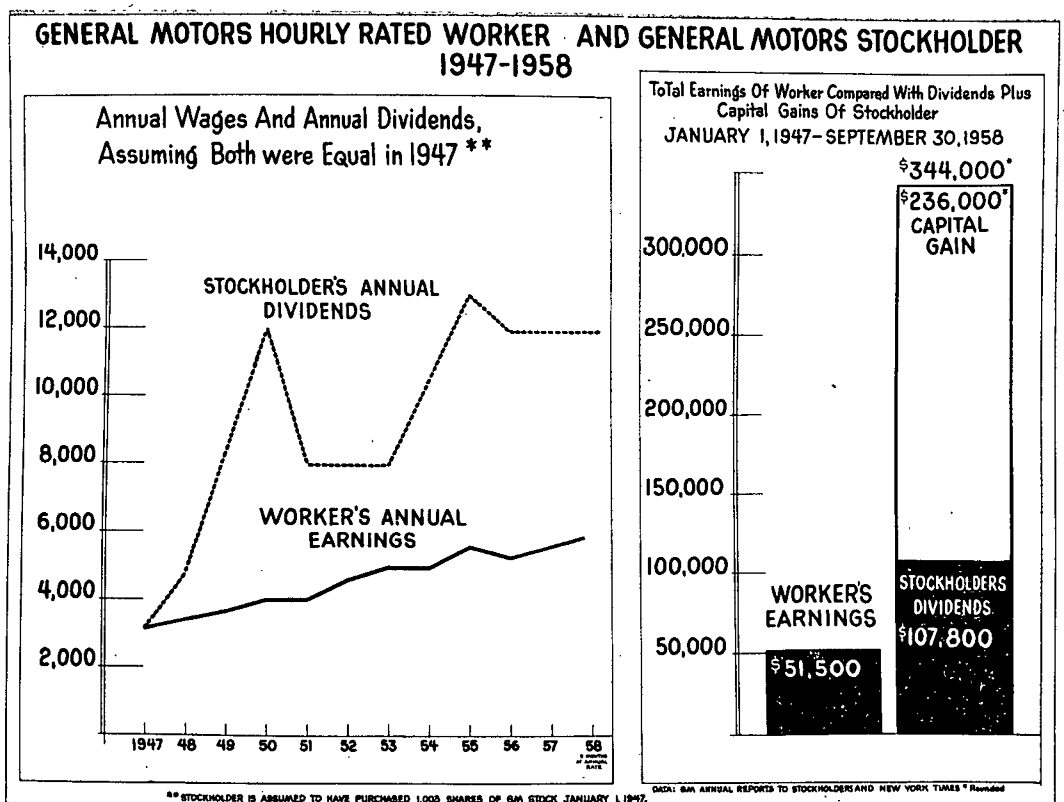
[1] Sources:
1909–37, Joint Economic Committee, "Productivity, Prices and Incomes," p. 89.
1937–47, BLS, "Postwar Productivity Growth in the United States" (years 1941–46 omitted).
1947–56, "President's Economic Report," 1958.

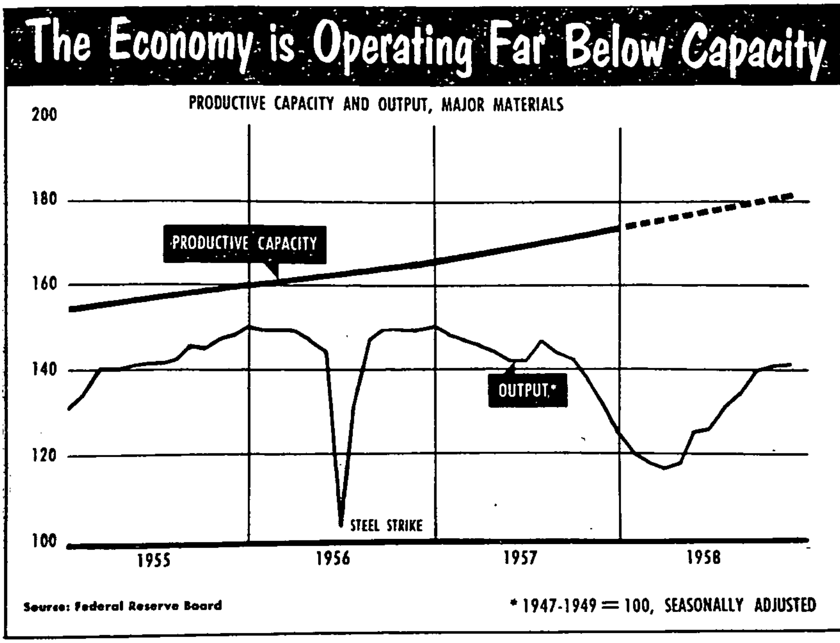
[2] Computed from the following least squares curve, second degree, based on the actual index numbers:

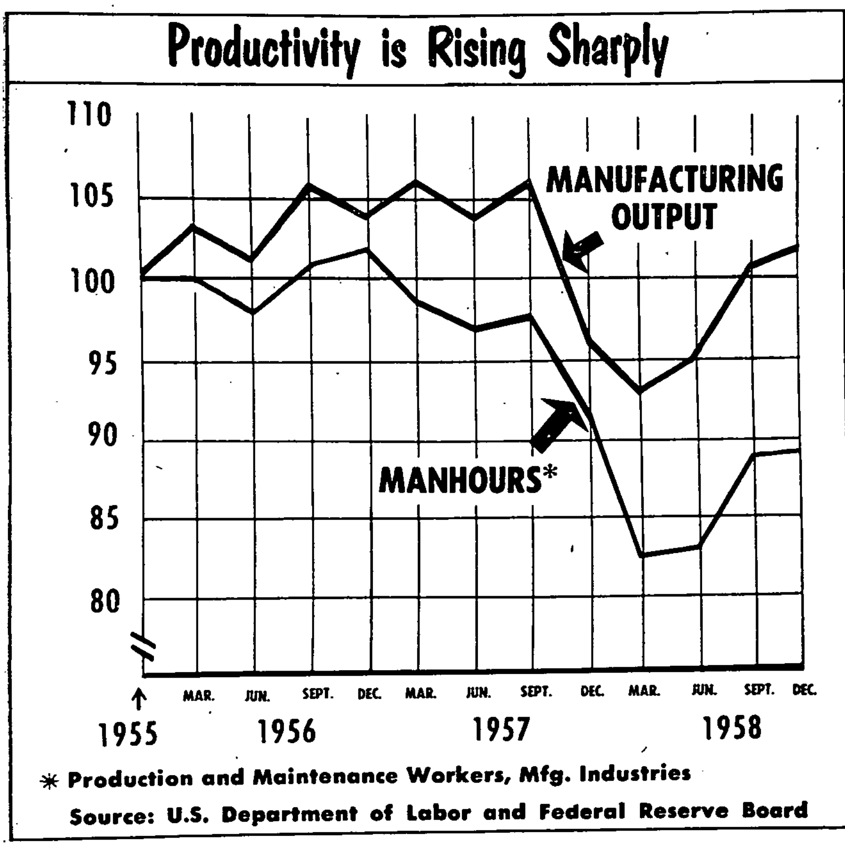
$$\log y = 1.66658 + 0.00341x + 0.0001373x^2$$

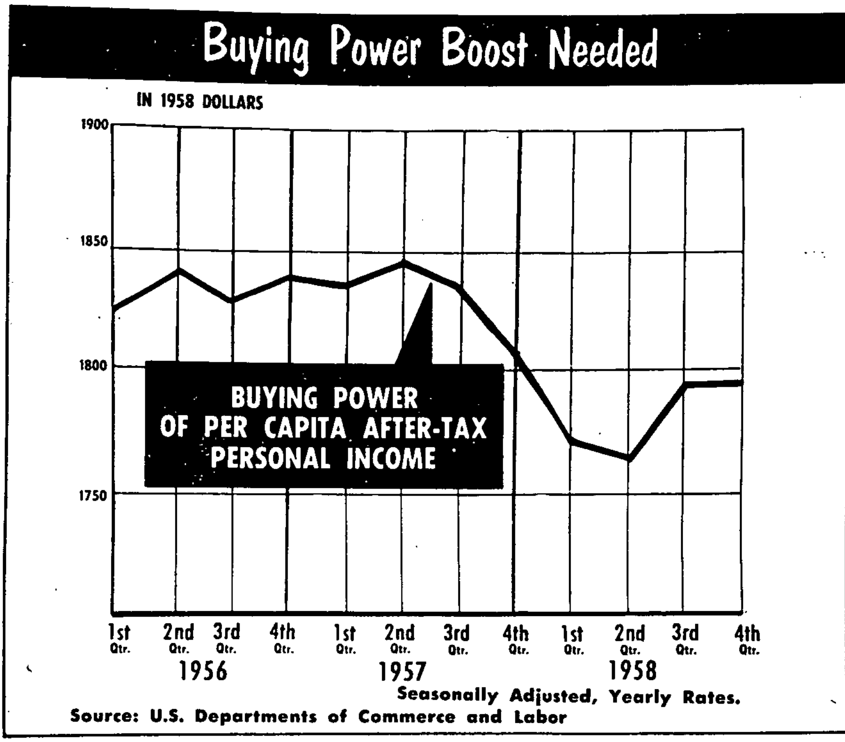
where $y$ is the computed index number and $x$ is the year number, 1909 being year 1.

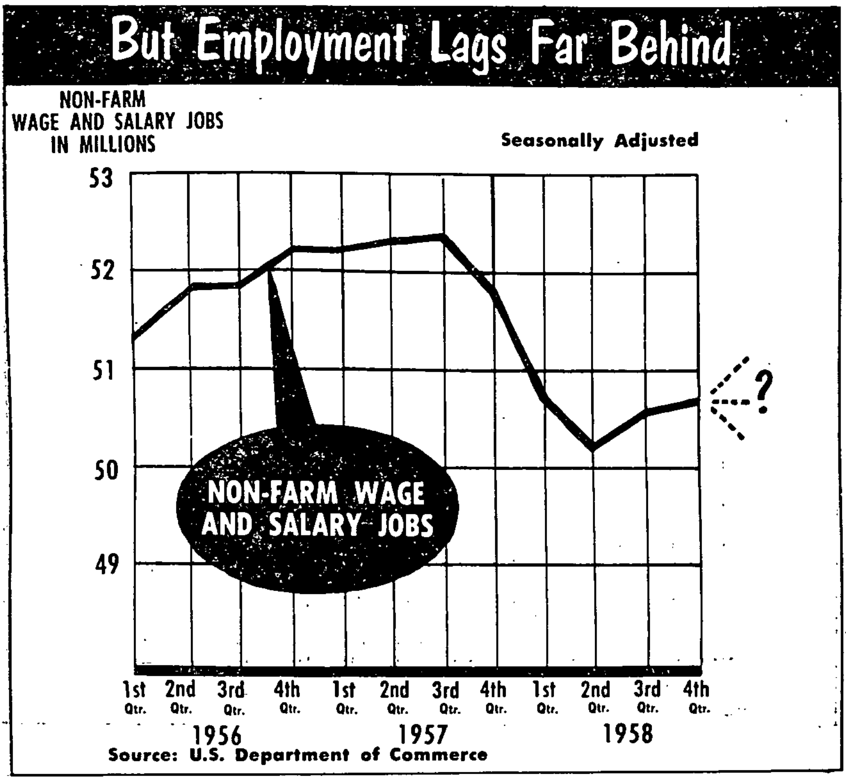
[3] Computed from logarithms of the index numbers.

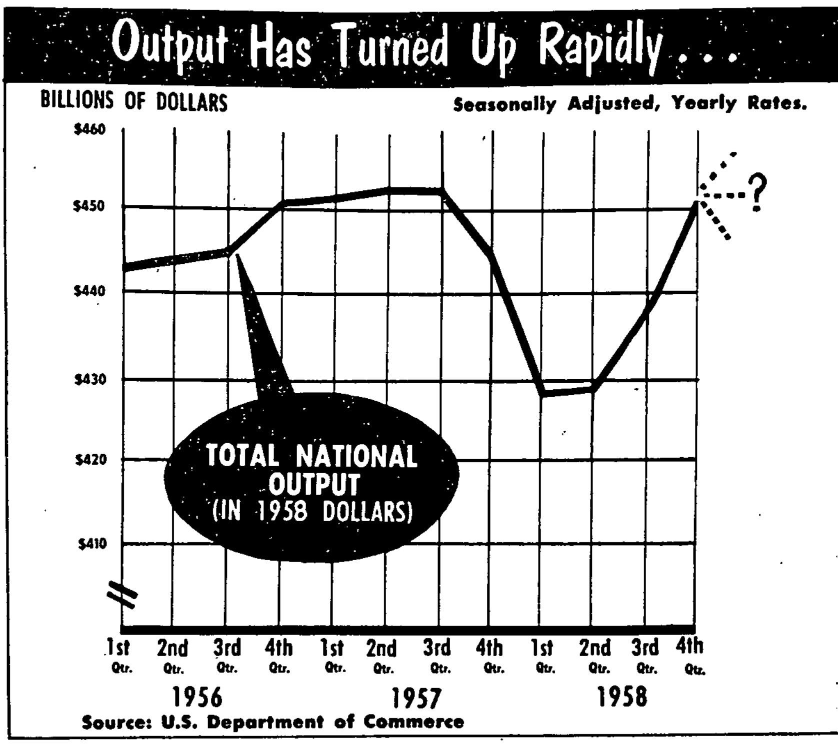

GENERAL MOTORS HOURLY RATED WORKER AND GENERAL MOTORS STOCKHOLDER
1947-1958
Annual Wages And Annual Dividends, Assuming Both were Equal in 1947 **
14,000
12,000
10,000
8,000
6,000
4,000
2,000
STOCKHOLDER'S ANNUAL DIVIDENDS
WORKER'S ANNUAL EARNINGS
1947
48
49
50
51
52
53
54
55
56
57
58
Total Earnings Of Worker Compared With Dividends Plus Capital Gains Of Stockholder
JANUARY 1, 1947-SEPTEMBER 30, 1958
$344,000*
$236,000*
CAPITAL GAIN
300,000
250,000
200,000
150,000
100,000
50,000
WORKER'S EARNINGS
$51,500
STOCKHOLDERS DIVIDENDS
$107,800
DATA: GM ANNUAL REPORTS TO STOCKHOLDERS AND NEW YORK TIMES * Rounded
** STOCKHOLDER IS ASSUMED TO HAVE PURCHASED 1,003 SHARES OF GM STOCK JANUARY 1, 1947.


The Economy is Operating Far Below Capacity
PRODUCTIVE CAPACITY AND OUTPUT, MAJOR MATERIALS
200
180
160
140
120
100
PRODUCTIVE CAPACITY
OUTPUT*
STEEL STRIKE
1955
1956
1957
1958
Source: Federal Reserve Board
* 1947-1949 = 100, SEASONALLY ADJUSTED

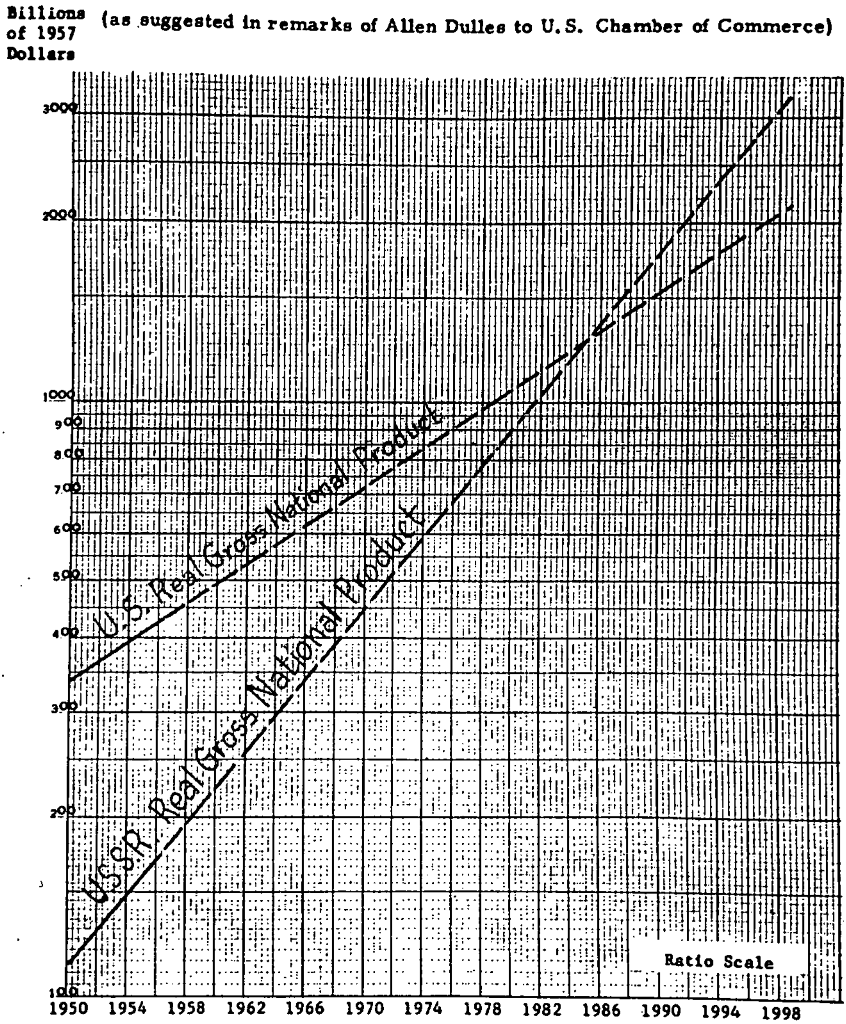

Productivity is Rising Sharply
110
105
100
95
90
85
80
MANUFACTURING OUTPUT
MANHOURS*
MAR.
JUN.
SEPT.
DEC.
MAR.
JUN.
SEPT.
DEC.
MAR.
JUN.
SEPT.
DEC.
1955
1956
1957
1958
* Production and Maintenance Workers, Mfg. Industries
Source: U.S. Department of Labor and Federal Reserve Board


Buying Power Boost Needed
IN 1958 DOLLARS
1900
1850
1800
1750
BUYING POWER
OF PER CAPITA AFTER-TAX
PERSONAL INCOME
1st Qtr.
2nd Qtr.
3rd Qtr.
4th Qtr.
1st Qtr.
2nd Qtr.
3rd Qtr.
4th Qtr.
1st Qtr.
2nd Qtr.
3rd Qtr.
4th Qtr.
1956
1957
1958
Seasonally Adjusted, Yearly Rates.
Source: U.S. Departments of Commerce and Labor


But Employment Lags Far Behind
NON-FARM
WAGE AND SALARY JOBS
IN MILLIONS
Seasonally Adjusted
53
52
51
50
49
NON-FARM WAGE
AND SALARY JOBS
?
1st Qtr.
2nd Qtr.
3rd Qtr.
4th Qtr.
1st Qtr.
2nd Qtr.
3rd Qtr.
4th Qtr.
1st Qtr.
2nd Qtr.
3rd Qtr.
4th Qtr.
1956
1957
1958
Source: U.S. Department of Commerce


Output Has Turned Up Rapidly . . .
BILLIONS OF DOLLARS
Seasonally Adjusted, Yearly Rates.
$460
$450
$440
$430
$420
$410
TOTAL NATIONAL OUTPUT (IN 1958 DOLLARS)
?
1st Qtr.
2nd Qtr.
3rd Qtr.
4th Qtr.
1st Qtr.
2nd Qtr.
3rd Qtr.
4th Qtr.
1st Qtr.
2nd Qtr.
3rd Qtr.
4th Qtr.
1956
1957
1958
Source: U.S. Department of Commerce

## Rough Projection of Comparative Growth, American and Russian Economies



Mr. Reuther. I think perhaps all the members of the committee are fully aware of the fact that your committee has come together at a time of crisis and challenge and that you are evaluating the President's Economic Report not in a normal period, but in a period of world history when America as the strongest of the free nations of the world must, of necessity, assume increasing responsibilities. I share the point of view that the American economy and what we do with it will be a decisive factor in whether or not we will be equal to the challenge that we face in the world.

Now, during the past week Mr. Khrushchev has discussed at great length, in the Communist Party Congress in Moscow, precisely what the Soviet Union intends to do in the future and he has laid down a broad and bold economic challenge to America.

I think that we need to understand that the American economy is in fact freedom's greatest material asset. How effectively and intelligently we mobilize its productive potential and how responsibly we distribute that potential both in meeting our needs at home and discharging our responsibilities in the world will determine whether the forces of freedom or the forces of tyranny are going to win this contest.

I believe that America is equal to this challenge if we try; and I think that the great tragedy of America is that we are not trying. Faced with this tremendous challenge, we are not really responding with a sense of urgency and a sense of awareness of the dimensions of this challenge.

Our system of freedom is equal to this challenge, but not if we work with one hand tied behind us.

We are equal to this challenge, Mr. Chairman, only if we recognize that it is perhaps the most threatening challenge that free men and free institutions have ever faced.

I share the point of view expressed by that great American, Gen. Omar Bradley, when he said recently:

> I am sometimes discouraged not by the magnitude of the problem, but by our colossal indifference to it.

This is the thing that bothers me about America. I am disturbed by what has been called the corruption of complacency. I fear that we have not really as a people, or as a nation, fully comprehended the nature and the dimensions of the Soviet challenge, nor have we, I think, understood the promise and the great potential of the American economy, if fully mobilized, to meet that challenge.

I have been saying for a long time to the people that I talk to in the labor movement and elsewhere, that in effect we are engaged in a kind of one-game world series with the Soviet Union. This is not a matter where you win four out of seven. You either win the first game or you lose all.

We are playing for keeps and nothing less than the survival of every decent human value that we cherish as a free people is at stake in this one-game world series.

Now, the American labor movement is deeply disturbed. We are very disappointed with the President's economic report, because we believe it lacks the sense of national urgency that leadership needs to create in this period of challenge. We believe that it fails to meet the requirements of the Employment Act of 1946 by not setting forth goals of employment, production, and purchasing power.

If you measure the President's proposed budget against the realities of the Soviet challenge and the Soviet budget, I think you will come to the conclusion that the President's proposals are a flight from economic reality.

I am afraid, Mr. Chairman, that we tend to confuse two values. The struggle in America and in the world is not for national solvency. It is for national survival.

The Soviet Union will not be impressed by any neat balancing of the books. The Soviet Union will only be impressed by the massive mobilization of the great productive power and the know-how and the genius of the American economy and the American people.

Yet we in the labor movement are disturbed by what appears to be an obsession about balancing the budget. The President seems in his report to put the cart before the horse. We believe that you cannot balance the budget unless you first balance the economy.

The only way we can get the fiscal and budgetary problems of America in order is by mobilizing the productive power of a full-employment, full-production economy

The average American understands that halfway and halfhearted measures were not adequate to meet the challenge of war. Yet too few people have understood that they are also inadequate to meet the infinitely more complex challenge of peace.

It seems to me that somehow in America we have to recreate the sense of urgency, that somehow we have to achieve a sense of unity and a singleness of purpose in the face of this challenge that is comparable to the unity and the urgency and the singleness of purpose that we achieved in the dark days following Pearl Harbor, because the challenge today is not less threatening than the challenge that we faced at that time.

I have a feeling, Mr. Chairman, that one of our problems is that our values are somewhat out of focus; that we need desperately in America, in this period of crisis, to get people together, Government and industry and labor, people generally, so that we can think through the values that we are dedicated to defend and extend in the world.

I think we need to work out a list of national priorities in which we begin to put first things first.

I wish America were as concerned about the size of its schools as it is with the size of the fins on the new cars.

Somehow we have not really understood what is important. If we could work out a list of priorities and then find a way to commit our total resources in a concerted effort to achieve these national goals, we could begin to get the American economy back into high gear, get America back to work. Only as we get America back to work can we have the economic resources to do what must be done at home and meet our increasing responsibilities in the world.

It is a great tragedy that at a time when we have tremendous unfilled needs at home and increasing responsibilities in the world the American economy is limping along in low gear.

We have at the present time, as we all know, more than 4 million unemployed. An unemployed worker is denied his opportunity of making his contribution toward the defense of freedom, toward the building of a stronger, better, more secure and happier America. Yet we have more than 4 million workers walking the streets of America.

As this chart indicates, Mr. Chairman, when you project our production capacity and our utilization of that productive capacity based upon actual output, there is a very serious gap between what we are doing and what we could be doing if we were fully utilizing our idle manpower and our idle plant.

You will find that there is roughly a 22 percent gap between potential output and actual output. We cannot afford this.

The margin of survival is too thin in the world, in the face of the massive offensive on the economic front by the Soviet Union, to tolerate that kind of gap between potential abundance and actual production in the American economy.

You begin to get some appreciation of the dimensions of the Soviet challenge and the dimensions of our failure to meet this challenge when you consider industrial production in the Soviet Union in 1958 as contrasted with industrial production in America.

Our industrial production went down 11 percent in 1958 and Russia's industrial production went up 11 percent.

The Soviet Union never misses a chance to make propaganda. Propaganda is a science with the Soviet Union. They put out literature at the Brussels World Fair in which they stated that industrial production from 1913 to 1957 went up 2,000 percent in the Soviet Union as contrasted to an increase of 200 percent in the United States.

The Soviet Union today, all over the world, is beating the propaganda drums. They are talking about unemployment and underutilization of productive capacity in the United States. With telling effect, they are beating this propaganda against the eardrums of hundreds of millions of people throughout the uncommitted world, charging that the American economy is incapable of achieving and maintaining full employment and full production, making the good things of life for people in peacetime. They argue that we are a Nation run by warmongers and that the only way we know how to get full employment is by making the weapons of war and destruction.

They keep driving this propaganda home in the struggle between freedom and tyranny for the hearts and minds and loyalties of hundreds of millions of the uncommitted peoples of the world.

Let us never forget that in the long run military power, while it needs to be strong, is but the negative aspect of a dynamic foreign policy. Through military power we buy time and the opportunity to win on the economic and social fronts in the struggle for the hearts and minds of people.

Sit down with the workers, as I did last week with a committee that came before our executive board in Detroit. They included people with 16 years of seniority in the automotive industry who have no hope of recall.

They have exhausted their unemployment compensation. They have exhausted the supplemental unemployment benefits we negotiated. They are without a job; they are without hope.

They ask me, Mr. Chairman, a very simple, reasonable, understandable question that I think America must find an answer to. Not excuses, not pious platitudes about how wonderful America is. We know how wonderful it is.

These workers say to me, "How come? When we were engaged in the struggle against the other kind of tyranny that Hitler represented in the world, every able-bodied man and woman in Detroit had a job. We worked overtime 6 and 7 days a week. We got the grandfathers and grandmothers out of retirement. They didn't give you a physical before they hired you in those days. If you were warm you went on the payroll."

They say to me, "How come? If we could have full employment and overtime making weapons of destruction, why don't we have the good sense to mobilize our economic resources, our productive capacity, our manpower to make the good things of life for people in peacetime?"

That is a reasonable question. Yet we have not met that challenge and Detroit is not unlike many other industrial centers.

I want to give you some figures about Detroit because I know more about that, personally. We have 194,000 unemployed workers in the city of Detroit. There are several cities all over America where they have comparable problems in other industries.

Nearly 13 percent of the labor force in Detroit is unemployed, yet the auto industry is perhaps at the highest level of employment that it will achieve in 1959.

Buick laid off 2,000 people last week. Ford laid off some people. We expect a general reduction in employment in the auto industry.

We have people from the Chysler plants with as much as 16 years' seniority who can't get called back. You can't understand unemployment until you experience it. It is not a mere philosophical, intellectual concept, but a deep human experience. Mass unemployment is a great tragedy, a great waste of the creative capacity of free Americans.

The Department of Labor tells us that we have 76 major labor areas with 6 percent unemployment, or more. We have 183 minor labor areas with 6 percent or more unemployed.

The unemployment figures will begin to edge up closer and closer, deep into February, to the 5-million mark unless we stop the present drift and stagnation in the American economy.

Therefore, I should like to suggest, Mr. Chairman, that what we need in America now and need desperately, is bold and affirmative leadership to get America back to work.

No people in the world have been so richly blessed as we have. We have resources, productive capacity, technical know-how, a skilled, industrious people.

All we need is the will to commit these resources to the achievement of the goals that we believe in.

I should like to suggest that a continuation of the deficit of leadership in Washington is much more serious than the deficit in our budget. Only if we get America back to work can we begin to create the economic resources essential to overcoming our deficits in education, our deficit in housing, our deficit in hospitals and medical care, our deficit in many aspects of our national life. The only way to create economic wealth is by the application of human effort to the tools of production and the material resources with which we work.

There is no other way to do it. Getting America back to work is the answer to this problem, in our opinion.

I do not believe that we ought to be misled by the movements of the stock market. The Soviet Union will not be misled.

If the stock market goes up a billion dollars that is a shuffling of paper; that does not create one more ton of steel or one more brick to build a needed schoolroom. Only work and the use of manpower and productive capacity will create economic wealth.

Neither should we be misled, Mr. Chairman, by the fact that our gross national product has climbed back up almost to where it was in the last quarter of 1956.

It is true that our gross national product went back up in the last quarter of 1958 to roughly $451.5 billion a year. It is almost back where we were 2 years ago.

Some people say that means we are out of the woods. Nothing could be further from the truth. As this chart indicates, while our production is almost back where we were, there is a very serious lag in employment. We have recovered roughly the gross national product of 2 years ago with roughly 1½ to 1¾ million less workers. In the period of the recession we have shaken down, gotten rid of some of the least efficient plants, put great stress on improving technology and increasing labor productivity.

I think that by any realistic evaluation of where we are going in terms of technology, electronics, and the wonderful new tools of production, we have the capacity to create unprecedented economic abundance.

You can never measure the possibilities of tomorrow by the inadequate standards of yesterday because we can grow tremendously and move forward at an increasingly accelerated speed. I get the feeling that we have not understood the great rewards that this abundance will make possible in America.

We have a choice to make. We must find a way to gear this increasing abundance to the needs and the aspirations of our people so that they can have higher living standards, a greater measure of economic security, and an increasing measure of human leisure, which they can use constructively and creatively. We must, in short, not only satisfy the needs of the outer man, but facilitate the growth of the inner man as well.

This, in truth, is essentially the area in which we stand apart from the Soviet Union. Never make the mistake of believing that they cannot produce as well as we can produce. I think that their achievements to date indicate that they can.

It is the essential motivation and purpose behind our material effort that separates the free world from the world of tyranny. Yet millions of American workers have been rewarded by the fruits of automation not with greater security, not with higher living standards, not with greater leisure, but with the tragic experience of unemployment.

In the automotive industry the march of technology goes on day in and day out. In 1947, to give you a comparison, we made 4,800,000 cars and trucks with a labor force of 649,000 workers.

In 1957, in 10 years, we went up to 7,200,000 cars and trucks, with a labor force of 652,000.

In other words, in that 10-year period we had a 50-percent increase in production and a one-half of 1 percent increase in manpower. But the 50-percent increase in production only tells half the story.

The cars and trucks were more complicated in 1957. They had automatic transmissions. They had many features that the earlier cars and trucks didn't have. They had eight-cylinder, complex engines as compared to very simple engines.

Here in this one industry, to bring this kind of figure very much up to date, in 1957 in the month of December the Ford Motor Co. made 189,000 cars and trucks with 124,000 production workers.

In December of 1958, they made 210,000 cars and trucks with 119,000 production workers.

Production was up 11 percent and employment was down 4 percent. In 1 year we had that kind of dramatic shift in the labor force.

The Federal Reserve Board, in a report that appeared in the papers yesterday, indicated that in December 1958 the output for the whole automobile industry was 4 percent lower than December of 1956, but production workers were down 20 percent between those two dates.

We cannot say, "Well, maybe we can somehow muddle through, this thing will get better." It will get increasingly worse, because the march of technology goes on and each time you break through into a new area you open up a whole new horizon of technological development which begins to have broad ramifications in the whole economy.

This is a matter which will confront us with more serious problems as we go down the road to the future. We in the labor movement believe that essentially we are in trouble because we have not learned to manage abundance. The only way we can manage abundance is to learn to distribute it equitably among workers, stockholders, and consumers so that we can achieve full employment and full production on higher and higher economic plateaus. Only by balancing productive power with purchasing power can the economic pie we create get bigger and bigger. Workers, stockholders, consumers, and people generally can share in that expanded economic pie as we achieve this dynamic balance.

No group in the economy can be short changed, denied their fair share of the fruits of our developing technology, without upsetting that dynamic balance that is essential to growth and expansion.

This is an area, Mr. Chairman, in which there has been a great deal more heat than light. There has been a great deal of propaganda, namecalling with everybody trying to put the monkey of responsibility on everyone else's back.

I think that we need a more rational, intelligent, factual discussion of the problem of inflation, its causes, and those who are responsible.

The President believes that inflation is the prime problem. He does not seem to understand that getting the economy back into high gear is itself a very effective anti-inflationary step.

But I think that basically the President makes a mistake in believing that he is fighting the classical kind of inflation, the kind, according to the textbooks, that develops when the demand for goods exceeds the supply or the ability of the economy to satisfy that demand.

When demand is up and supply is down in classical theory, prices rise until supply and demand balance out.

When supply is up and demand is down you get the reverse impact, with prices declining.

That is very good theory, I suppose, if you are taking a freshman course in economics and are not going beyond that freshman course.

But in this situation the demand for goods is not pressing upon the supply and pushing prices up, because in basic industry after basic industry we have a tremendous unused capacity. We don't have a shortage of capacity in the automobile industry. We have a shortage of customers.

What we need is more people with enough purchasing power to buy the cars and bring that unused productive capacity into operation. But the President, unfortunately, would have us believe that we are fighting the classical kind of inflation. The things that he recommends to deal with that kind of inflation are not realistic in dealing with the kind of special inflation with which we must deal.

We have an inflationary recession which is completely unrelated to the kind of problems that we had in the past. We have inflation that grows essentially from the fact that a few giant corporations in the American economy, exercising monopolistic power and dominant control over vital sectors of our economy, are able to set their prices without regard to the pressures of the marketplace.

I think a good example of this is the steel industry. The steel industry has inflicted upon the American public and the American economy 23 price increases since the end of the Second World War.

Each time they have done that they have said to the people of America in this propaganda contest that they have been forced to raise prices because of the wage demands of the steelworkers. Yet the facts will show that for every dollar they gave the steelworkers in higher wages, they charged the American consumer $3.23 in higher prices.

Whoever believes that the law of supply and demand has not been repealed by these giant corporations who determine the basic price trends in the American economy should consider the strange phenomenon that occurred last August, when the steel industry made its 23d price increase at a time when it was utilizing less than 60 percent of its capacity.

Adam Smith said that when you are using less than 60 percent of your capacity and the prices are up, the prices are supposed to come down. But the steel industry has repealed the law of supply and demand.

The CHAIRMAN. Mr. Reuther, we set up the program this morning with an hour to be devoted to your statement and questions asked by members of the committee and the subsequent hour to hear the representatives of the chamber of commerce and the NAM.

Now, the chairman apologizes for the fact that he was late this morning and he realizes that set us back 10 minutes. The chairman recognizes that he is at fault in this matter and wishes to apologize to you and to the other members of the group. But you are in good form now; you have taken 30 minutes and I see you still have a lot of notes.

I wonder if you would be willing to yield for discussion on your paper. I think nearly all the members have been reading your paper so that we can have a chance to question you.

Mr. REUTHER. I intend to finish very quickly so that can be done. I want very much to be able to respond to your questions.

I should like to put in the record and call to your attention an editorial in yesterday's Washington Post entitled "Those Administered Prices."

The Washington Post editorial begins to put its finger upon the real source of our inflationary problem and it refers to an article which I should like to put in, also, entitled "Inflation Besetting Us of a New Breed."

This is precisely the problem that the President does not deal with. He is still dealing with the classical kind of inflation, which is not our problem.

(The material referred to follows:)

[From the Washington Post and Times Herald, Feb. 8, 1959]

### THOSE ADMINISTERED PRICES

If Majority Leader Johnson is looking for a good point of departure for the large-scale, much needed national economic study which he has promised, the noted economist Gardiner C. Means has certainly provided one. Mr. Means has demonstrated in a novel and forceful way what many economists long have felt; that the big, concentrated industries tend to maintain through thick and thin a long-term policy of gradual price increases that no reasonable exercise of traditional monetary and fiscal controls can curb.

Bernard D. Nossiter describes the Means findings in an illustrated article elsewhere in today's Outlook section. It should make fascinating reading for all who have wondered why price indexes seemed to rise throughout the last recession, showing conclusively the heavy proportional impact of the concentrated industries on this trend.

Mr. Means' basic findings seem sound, indeed, but obviously are of so great an importance that they deserve further independent review and refinement. His attempt to assign responsibility for price rises in these industries as between management and labor is, if less conclusive, no less challenging. The suggestion that in steel, for example, prices rose six times as much as labor costs in 1956–57 literally cries out for further study in this and other industries.

The implications of the Means' study are by no means simple. Certainly the study warrants no pell-mell political race to clobber industry with controls or exhortations to be "more responsible." Indeed, it could be concluded that "big business" displays a kind of public-spirited statesmanship in refraining from taking full advantage of periods of short supply to push up prices. And it could be argued that industry, holding to a steady pace on price and wage increases during recessions, contributes to a needed stabilization of purchasing power. On the other hand, the seeming ability of the concentrated industries to defy the usual economic laws upon which so much public policy is based should spur a search for new means to get a fuller representation of the public interest in big industry decisionmaking.

The most urgent and timely implication of the Means study, however, is that the Eisenhower administration is winking at the realities of the business world in continuing to place so heavy a reliance on traditional economic controls at this time. It is not now apparent that full utilization of labor and plant capacity will be achieved this year, so the upward pressure on prices in 1959—if any—will be coming mostly from the administered pricing activity of the concentrated industries.

Yet the response of the administration to this prospect has been to call for tighter credit, less Federal spending, and general restraint—the traditional measures which the Means study shows have little impact on big business pricing. These policies could depress activity critically in the competitive industries, nipping at the outset the recovery upon which Mr. Eisenhower's "balanced" budget itself depends.

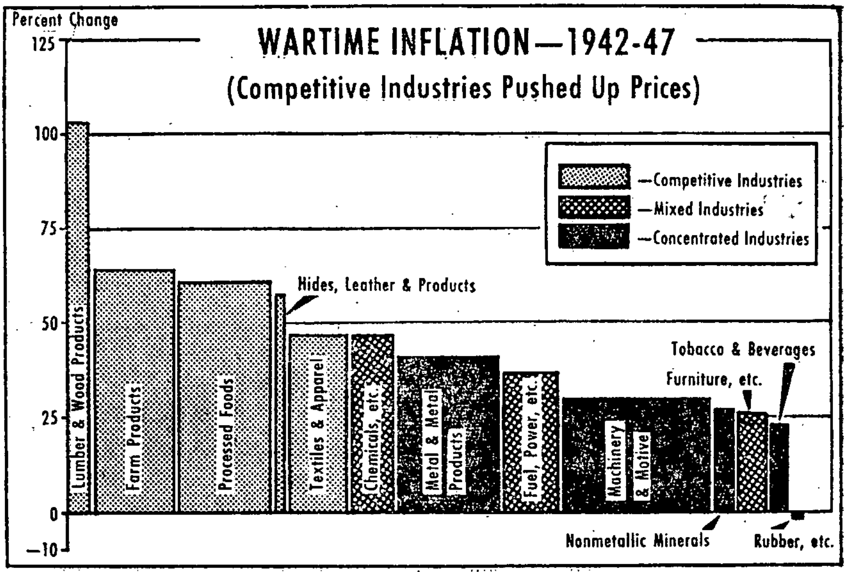
Mr. Means has made an invaluable contribution to an understanding of one of our most perplexing economic problems. Senator Johnson is to be congratulated for seeing even earlier the critical importance of intensive study in this field—and he has now an excellent springboard from which to launch it.

INFLATION BESETTING US IS OF A NEW BREED

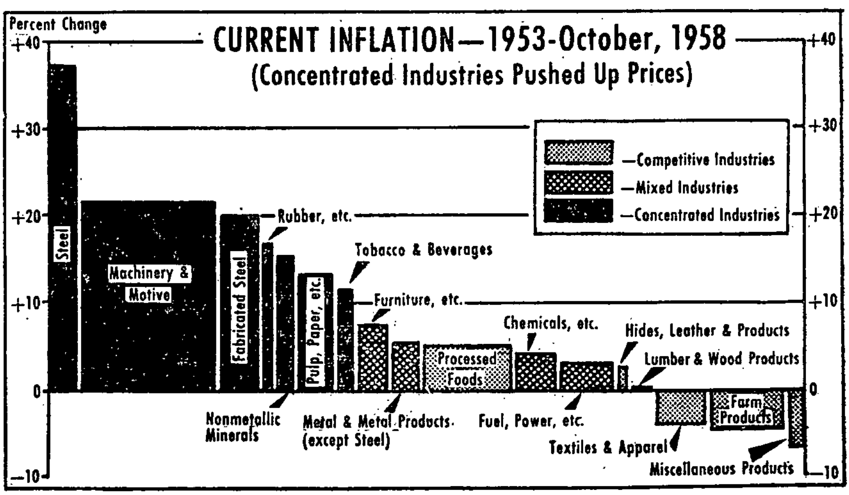
(By Bernard D. Nossiter)

A pioneering approach to the peculiar price inflation that marked our recent past is embodied in the strange-looking charts below.

They were put together by Gardiner C. Means, of Vienna, Va., a distinguished but lonely economist. He held a slew of Government posts in New Deal days and was recently an adviser to a relatively sophisticated business group, the Committee for Economic Development. Twenty-seven years ago, Means shocked economic thinking when he and Adolf A. Berle wrote "The Modern Corporation and Private Property."




*In both charts, the height of each bar is the percentage increase in the wholesale price of each industry's or industry group's products. The width of each bar is the industry's weight in the Bureau of Labor Statistics' wholesale price index. From 1942 to 1947, the average price increase for the groups pictured was 50 per cent; from 1953 to October, 1958, it was 8 per cent.*



What the Means charts show is that contemporary inflation is a very different animal from the classical demand inflation. The chief difference lies in whether big price increases come in competitive or concentrated industries.

In other words, what Means has done is violate a sacred taboo of economic thinking. He has actually gone and looked at where the price increases are taking place and asked whether the differences over separate periods of time aren't meaningful.

To compound his sins, he has married economic theory to economic fact. And as everybody in the business knows, the gulf between the "institutionalists" (fact men) and theoreticians is a wide as the breach between Montagues and Capulets.

Classical inflation is pictured in the top chart, covering the war and immediate postwar years. This was a money phenomenon, an increase in money demand which was not offset by an equivalent increase in goods—what Federal Reserve Board Chairman William McChesney Martin likes to call, "too much money chasing too few goods."

In drastically oversimplified form, this is what happened:

The staggering war expenses were paid by the Government through borrowing (deficit financing). To the extent that the Government borrowed (sold bonds) to commercial banks, the Government was simply printing money. The goods this money bought were shot off, exploded, dropped on cities, or left to rot in military warehouses. So, when controls came off, the extra money in the hands of people and businesses bid up prices much more than it induced increased production. Even with the best will in the world, increased production could not come about quickly enough because resources of men and materials were almost fully employed—too much money was chasing too few goods.

According to Means' charts, the biggest price increases came in the highly competitive industries—lumber, farm products, processed foods, textiles. In these, producers can't control their prices which are set by those impersonal market forces so dear to Adam Smith.

But the concentrated industries with few producers—steel, autos, aluminum, electrical machinery—held back. They do have considerable discretion over price and didn't take full advantage of the big increase in money demand.

Now, the new inflation presents a different picture. All the price push comes from the concentrated industries. The competitive industries in several cases cut prices—textiles, farm products, miscellaneous. And there is a logic in this. The period under study, 1953 to October 1958 (the last month for which Means got data), was a time of much less than full employment. The period spans two recessions (1953–54 and 1957–58). The money supply did not zoom upward.

So, only industries who need not rely on impersonal market forces but have considerable control over their prices could make increases stick. And the charts show that they did.

Many economists will quarrel with Means' interpretation of his charts. They will contend that the ability to administer prices has nothing to do with whether an industry is competitive or concentrated. They will argue that all Means is showing in his new inflation chart is what you would expect in a period of investment boom—and the Nation certainly was enjoying one from 1955 through 1957—steeply rising prices in steel and other producer goods industries as the result of extra demand for producer goods.

This debate can't be settled in this space or anywhere else now because relatively little is still known about administered prices, or for that matter, concentration.

Let's take a closer look at the charts. The solid black bars are industries or industry groups which are highly concentrated—a handful of producers account for most of their production. The cross-hatched bars are mixed concentrated and competitive—chemicals, furniture, and the like. The light gray bars are the competitive industries with thousands of producers, no one of them big enough to affect prevailing prices or production.

The bars are two-dimensional, but that's not as scary as it sounds. The height of each bar measures the percentage of price increase or decrease at wholesale in each industry. For example, in the bottom chart, steel prices went up 36 percent between 1953 and October 1958; farm products prices went down 5 percent.

The width of each bar measures the industry's weight in the wholesale price index—that is, the amount of sales of that industry in relation to the amount of sales of the other industries. If steel sales during 1953–October 1958 were $8 billion and farm products sales were $24 billion, then the farm products bar would be three times wider than the steel bar.

The height of any bar times its width is its area. In these charts, the height (price increase) times width (economic weight) gives a graphic picture of the economic impact of each industry on the price level. In other words, the area of each bar shows how much force each industry or industry group had on the price level.

We can see very quickly that the competitive industries accounted for almost all the pull in the war period. There is much more light gray than black in this picture.

But in the recent period, the push comes from the concentrated industries. Means figures that they account for 85 percent of the gross increase in the wholesale index. If they hadn't gone up in price, the wholesale index would have risen less than 1 percent instead of 8 percent. And this is what you would expect during a period when total output of goods is increasing little and so is the money supply.

There is one other point to note. In the bottom chart, Means has broken out steel and fabricated steel from the broad category of metal and metal products. He did this to demonstrate the overwhelming force of the steel and steel-using industries (machinery and motive) in pushing up recent prices.

While Means appears to have demonstrated that the new inflation stems from the concentrated industries, he still hasn't answered the question agitating political debate: Is it the unions or is it the corporations?

Is it Roger Blough's United States Steel, Frederick Donner's General Motors, Ralph Cordiner's General Electric? Or is it David McDonald's United Steelworkers, Walter Reuther's United Auto Workers, James Carey's International Union of Electrical Workers? Or, have both sides embarked on an unspoken wage-price or price-wage collaboration?

The charts are of no help here. But Means, who prepared his material for the Senate Antitrust and Monopoly Subcommittee, went back into the committee's steel hearings for some arithmetic. After lengthy calculations, based on a series of arguable assumptions, he concluded that labor costs per ton went up $1.75 during 1956–57; prices went up $11 ton.

This would appear to make United States Steel, the industry's price leader, the chief culprit. However, it must be repeated that Means' computation is derived from assumptions which can be debated. At best, his conclusion is suggestive.

Who are these concentrated steel and steel-using industries? They can be reduced to 10 corporations. In terms of ingot capacity, steel is United States Steel (29 percent); Bethlehem (16 percent), and Republic (9 percent).

The "motive" end of the "machinery and motive" category is: General Motors (51 percent of 1958 auto production); Ford (29 percent), and Chrysler (14 percent).

The machinery end is tremendously complicated by definitions. But electrical machinery is General Electric (owned 16 percent of the industry's assets in 1947, the last data year); Westinghouse (13 percent); Western Electric Co., an American Telephone & Telegraph subsidiary (13 percent), and Radio Corp. of America (6 percent).

Some policy implications flowing from Means' analysis were spelled out by Chairman Estes Kefauver, Democrat of Tennessee, of the Senate subcommittee. If Means is right, then:

A tight money policy won't hold down prices without bringing on a recession because corporate giants are the least affected by a shortage of lendable funds. They raise their expansion money largely from profits, not borrowing.

A balanced Federal budget is irrelevant because this is not a money, but an administered price inflation.

To be sure, easy money and unbalanced budgets would, according to anybody's analysis, worsen the situation by piling a money inflation on top of an administered price inflation.

However, a minority group of economists, headed by Leon Keyserling, paradoxically argues that easy money and budget deficits will stimulate an offsetting amount of extra production when, as now, men and resources are not fully employed.

But what Means is really saying is that some new institutional devices must be invented to control concentrated industries and/or their unions if price stability is to be achieved.

What form the new devices should take might well be on the agenda of Vice President Richard M. Nixon's new Cabinet committee on inflation and the massive

**congressional study Majority Leader Lyndon B. Johnson, Democrat of Texas, once proposed for the Joint Economic Committee.**

Mr. REUTHER. In this editorial they referred to a study made by Mr. Gardner Means. The study, dealing with the 1956–57 price increases in the steel industry, points out that for an increase in labor costs, taking productivity into account, of $1.75 per ton, they jacked up the price to the American consumers $11 per ton.

In achieving a relative equity between workers, stockholders and consumers, this whole question of administered prices is the key. It determines how we share the abundance that we are capable of creating. It prevents our achievement of a dynamic relationship that facilitates growth.

I would like to show you a larger chart which we think is a dramatic way of reflecting the relative equity of worker and stockholder. This is based on General Motors Corp. experience from January 1, 1947, to September 30, 1958. We assume an average General Motors worker who is employed 52 weeks in the year. This is a very hypothetical GM worker. I don't represent that kind. We also assume a shareholder owning enough stock in January 1947 to have earned that year in dividends the equivalent of what the average GM worker earned. In other words, the stockholder and the worker start out even.

This is what has happened to the wage earner:

He earned $51,500 by 11¾ years of work on the basis of a 52-week year.

What happened to the stockholder? You always hear spokesmen for big business organizations talking about the need to provide more incentive on top, to the people who create capital and job opportunities.

In that same period, while the worker was earning $51,500, the stockholder received $107,800 in cash dividends. Through appreciation in the value of his stock, he gained $236,000 in capital gains, so that his increased equity was $344,000.

So that less than $8,000 invested in General Motors in that 11¾-year period would have earned the equivalent of what a worker earned who put in 11¾ years of hard work.

One talks about relative equity. Yet the stockholders who enjoyed this greater share would put the burden of responsibility for inflation on the wage earner.

If this were in some underdeveloped country, where a small investment in capital goods would yield a high return compared to the effort of a human being, you could understand it. But this is America, with automation and developing technology.

In other words, a person having $8,000 to invest could have lain in the sand of Miami Beach and had the same income as a worker bucking the assembly line every week during all those years.

We believe that is a very clear demonstration that the wage earners have not been the culprits.

Here is an industry where profits have been, I think, fantastic, and where wage earners and consumers have been shortchanged in comparison with other groups.

When I was before the Kefauver committee on behalf of my own union, the UAW—I refer you to the prepared statement—I proposed a public agency that would conduct hearings on proposed price and wage increases in "administered-price" industries. We don't say this is the only mechanism. We can say we think Congress should explore this whole area. How can we, within the framework of our free economy, and without imposing controls, provide voluntary mechanisms that will make private economic decisions more publicly responsible? Unless we find a way to make private economic decisions more responsive to the needs of the public and the needs of the whole community, we will be in trouble, for then the Government, not by choice, but by necessity, will be compelled to move in and begin to narrow the areas of voluntary economic decision.

The President thinks fighting inflation is the most important thing and he is fighting the wrong kind of inflation. I should like to empahsize that the most important thing that we need to do is to move from the present state of economic stagnation and find a way to facilitate the essential growth of the American economy.

When we talk about the cost of education and housing and all the other costs of growth, people say, well, it is all very fine, but we cannot afford it. We can afford it if we will mobilize the abundance of our economy, if we will facilitate the maximum growth that we are capable of achieving.

But the great tragedy is that at a time when the Soviet Union is moving ahead at a tremndous pace compared to our expansion, we have been limping along in the period from 1953 to 1958 with less than a 2-percent annual growth in our national economy. What we need is an annual growth rate of about 5 percent.

If we had grown from 1953 through 1958 at our rate of growth from 1947 to 1953, we could have had $140 billion more in gross national product over that period.

That is $2,800 per family in America.

If we had grown at the rate of 5 percent from 1953 through 1958 we could have had $212 billion more in gross national product.

I would like to put in the record, and recommend for your reading, an article by Mr. Edwin L. Dale, of the New York Times, January 26, 1959. He points out the low growth of our economy and the fact that Mr. Krushchev, maybe as part of his propaganda, said the Soviet Union was going to expand at the rate of 8.6 percent a year.

(The material referred to follows:)

[From the New York Times, Jan. 26, 1959]

TORTOISE AND HARE—SLOW PACE OF U.S. ECONOMIC GROWTH SUGGESTS THAT SOVIET MAY WIN RACE

(By Edwin L. Dale, Jr.)

WASHINGTON, January 28.—Nikita S. Khrushchev predicted yesterday that economic growth in the Soviet Union over the next 7 years would come to about 8.6 percent a year. Judging from recent performance, he may not be far wrong. Mr. Khrushchev said this compared with an annual rate of growth in the United States of 2 percent. He was being unnecessarily kind. Since the end of the Korean war, the annual economic growth of this country—after correcting for higher prices—has averaged less than 1.5 percent.

The experts are deeply divided on the two most obvious questions:

Why has the slowdown in growth occurred?

What ought to be done about it?

Economic growth is usually measured by the increase in the "real" gross national product, or total output of goods and services, after allowing for price changes. Growth come about because the labor force grows each year and because, with the aid of machinery, each worker's "productivity"—his output for each hour worked—also increases each year.

"NORMAL" RATE AT LEAST 3 PERCENT

The rate of growth has varied widely during U.S. history, but by almost any test the recent experience has been disappointing. There have been periods—1947–53 was one—when growth in real terms came to 5 percent a year or more. Almost no expert puts "normal," achievable growth at less than 3 percent a year, and many think it should be more.

Practically everybody favors a high rate of economic growth. It improves living standards. It supplies more and more revenue to governments at all levels, without raising tax rates, to do the many things that governments now must do and in the future will have to do even more. But how do we get it?

"We" in this case clearly means mainly the general government.

CAUSE AND CURE DEBATED

The arguments range over the cause of the recent slowdown and what should be done now.

All sides concede that the main reason for the decline in the average rate of growth over the last 6 years has been that this period saw two recessions during which the economy went down rather than up. All sides also agree that the rate of growth in the long run will depend on the rate of increase in plant and equipment (national "capital"), plus the rate of increase in our technical skills and inventiveness.

But after that, the disagreements begin.

Some say far greater Federal spending is essential to speed up the rate of growth. Others say the exact opposite: That the best prescription for growth is lower spending and hence lower taxes, which would supply more investment capital.

Some think the present situation calls for budget deficits; others believe large surpluses are the right medicine.

Some say high interest rates and "tight money" greatly deter growth and are mainly to blame for our recent slowdown. Others say high interest rates increase savings and thus help growth, and also help growth by checking inflation.

ROLE OF INFLATION ARGUED

Some say a little inflation is probably the price that must be paid for more rapid growth. Others say that toleration of even a "creeping" inflation will result in uneven growth, and less growth in the long run, with more frequent "busts" or recessions following inflationary booms.

Some say that growth can best be stimulated by tax relief aimed at encouraging more investment in plant and equipment. Others say the reverse: That the best stimulus would be to cut taxes for low-income groups, thus increasing demand and inducing businessmen to expand.

Some say higher wages are essential to spur the rate of growth. Others, with equal conviction, say that greater profits are the key.

All of these differences are fundamental. The differing viewpoints are held by nonextremists on both sides. And meanwhile growth has practically ground to a halt.

This year, to be sure, will see a pickup in the rate. That always happens after a slump ends. But the period that has greatly disturbed experts of practically all viewpoints is the "prosperous" period of 1956–57.

Following the typically rapid growth of the postrecession year of 1955, growth in 1956 was only 2.4 percent and in 1957 it was 1.1 percent. Why? Until the experts—let alone the politicians—come to some agreement on the answer, Mr. Khrushchev may make good his boast about catching up to the United States by 1970.

Mr. REUTHER. Mr. Allen Dulles has made a study of Russian growth. Based upon the figures he gave to the United States Chamber of Commerce meeting I think, in 1957, we have projected the growth of the American economy, which is based roughly upon a 2½ percent annual rate.

You can see what happens. The Soviet line rises sharply and crosses the American economy in terms of gross national product not too far down the road.

What we need to understand, I believe, Mr. Chairman, is that the difference between what we have done and what we can do is more than just a matter of economic progress, high living standards.

In the world in which we live it is the margin of survival. We cannot meet the challenge unless we begin to raise our sights.

Project a 2-percent rate growth for a 25 year period and contrast that with a 5-percent rate growth. Here are the sort of figures you get. It is in the dimensions of these kinds of economic facts that we have to find the answers to America's problems.

A 2-percent rate of growth from the 1957 peak means $740 billion in gross national product after 25 years, using 1958 dollars.

A 5-percent rate would give us, at the end of that 25-year period, $1,527 billion, or a gross national product gain over that achieved by growth of 2 percent of $787 billion.

That is where we have to find our new schools. That is where we are going to have to find our medical care and security for our older people and the defense posture that we need and the economic aid program to help the underdeveloped peoples of the world stand up against the Soviet Union's economic penetration and subversion.

Yet we are not realizing that tremendous abundance that is there to be had.

We believe that the Federal Government has the authority and the responsibility to find a way to get America back to work. The private sectors of our economy have their own responsibility, but they cannot raise America up by its economic bootstraps.

The Government must provide the leadership and the will to get America back to work. We have listed many things specifically in our prepared text which I don't have time to list here: the depressed area bill, minimum wages, the community facilities bill, aid to education.

The Russians have that satellite in orbit around the sun because they have worked on metallurgy and they have done a much better job in that field than we have.

They are turning out 10 times as many competent metallurgists as we are.

I would like to suggest that we give consideration to creating some mechanisms in America by which we can get on top of this whole problem of our developing technology. You cannot expect the blind forces of the marketplace to meet the complex challenge to our society in the world of automation and atomic power.

We also need to work on the progressive reduction of the workweek. This is not an arbitrary thing. It is a matter that ought to be dictated by the facts of technology, by how much progress we can make in satisfying our material needs and giving people a fuller measure of leisure.

This is not an arbitrary thing that we can decide at the bargaining table; that you can decide or the President can decide. It has to flow from the economic facts.

We believe that Congress has the responsibility to help provide the leadership to do the job that needs doing, to get America back to work; to put idle men back to work; to put idle machines back to work, so that we can all help create the abundance which is the key to overcoming our deficits at home and enabling us to meet our increasing responsibilities in the world.

Thank you.

The CHAIRMAN. I think that we should terminate the interrogation of Mr. Reuther by 11:15, in order to give full opportunity to Mr. Fackler and Mr. Robey.

I suggest, therefore, that we restrict our individual questions to 5 minutes. I first call on Congressman Patman.

Representative PATMAN. Thank you, Mr. Chairman. I will try to make one point if it is possible.

In allocating the selling cost of an automobile, do you know how much the manufacturer usually sets aside for expansion capital?

Mr. REUTHER. That varies. In the automotive industry since the end of the war, I think Ford and General Motors together have expanded roughly $5 billion, of which roughly 90 percent was financed by American consumers.

The bulk of postwar expansion was financed out of their price structure, out of the pockets of consumers.

The amount set aside varies. 1955 was the most profitable year in General Motors because the volume was up; we had an 8 million car year and I think you understand, Congressman Patman, that volume is the key to cost because you have your basic cost and your tools and your plant equipment; if you can get volume, the cost per car comes down very fast as the volume goes up.

So 1955 was their most profitable year. General Motors made $2½ billion, or 76 percent profit on their investment before taxes and they set their prices before taxes.

Yet despite those fantastic profits of 76 percent return on their investment, they raised the price of their cars. So in that year they evidently put aside much more than in the year when the volume was lower and they, therefore, had less to work with. They have put aside very sizable funds since the war.

Representative PATMAN. Have you made effort to translate that into the amount per car on a percentage basis, or otherwise?

Mr. REUTHER. It is very difficult to figure that out in any very accurate way because General Motors, for example, has such a diversification of production. They make automobiles, trucks, diesel locomotives, and many other things. It is very difficult.

When we were before the Kefauver committee we got into this thing as best we could. There, again, you see, it varies with the volume of production. This is a changing kind of economic equation.

In our opinion, the automotive industry was one of the offenders in administered pricing, where the inflationary pressures, we believe, were generated.

Certainly General Motors and the other big corporations in our industry have to assume a share of responsibility in that regard.

Representative PATMAN. I believe you can state, though, Mr. Reuther, that definitely a certain amount is decided upon and is allocated for expansion capital, an effort is made to allocate so much on some sort of basis for expansion capital?

Mr. REUTHER. I cannot give you a specific figure on that. As I say, it varies, based upon their volume. In some years it would be $100 per car; in very prosperous years it would be considerably more than a hundred.

Representative PATMAN. The point I am trying to bring out is that it occurs to me that is wrong for this reason: That in selling an automobile and charging the customer $100 extra, or $500 extra and then using that extra money for expansion capital, the customer is not treated fairly because he should have been given that car at that reduced price and then permitted to make that investment, himself, of $100 or $500 in the company and get the returns on it instead of the existing stockholders.

Do you see any evil in that procedure the way the automobile companies handle it by getting this capital from the consumers?

Mr. REUTHER. I think it is improper. I think they ought to sell their car to the consumer without setting aside the money necessary for self-financing. Then the consumer could accumulate the money he saved by a lower price. And if they could entice him to invest that money in General Motors, that would be the proper way to get the money.

By putting the cost of expansion into the price, the consumer is being compelled to pay the cost of expansion, but he does not wind up owning the company.

The CHAIRMAN. Congressman Kilburn.

Representative KILBURN. Mr. Reuther, we are all for the same objective that you state in your statement. What I do not quite understand is that you said in effect in your statement that the old-fashioned inflation does not affect us any more; something to that effect.

Of course, a great many countries in the world have had inflation very much worse than ours. Our dollar has gone down about 50 percent in the last 25 or 30 years and if our dollar goes down in value any more the Soviets certainly will be on top.

We have to keep a sound economy in my judgment in order to fight the cold war the way we want to. Anything that tends to depreciate the dollar is helping the Soviets.

It seems to me we have to arrange our economy so that that does not happen. If we simply go out and spend more without being able to sell more goods, I think that will happen. Do you?

Mr. REUTHER. To begin with, I think we could all agree that at the end of the war, during the postwar period, we had classical inflation because of this tremendous reservoir of demand and purchasing power that built up. There we had classical inflation and we should have dealt with it as such.

We don't have it now because during the recent recession we had a situation where we had prices going up even though production was coming down. This is completely contrary to all the rules of economics.

Prices have been going up in the steel industry even though at one time they were using only 47 percent of their capacity, at the low point of recession.

The auto industry was using only 45 percent of its capacity. Yet they kept raising prices.

The way really to meet the problem of inflation, we believe, is to begin to find a mechanism to make private economic decisions publicly responsible and get the economy back in high gear, because the only real way to offset the threat of inflation is to provide for the full utilization of your productive capacity, both machinery and manpower.

As I said before, do you think an unemployed worker is making a contribution toward fighting inflation?

Representative KILBURN. If you cannot sell your goods, that is the basic problem.

Mr. REUTHER. Why can't you sell them?

Representative KILBURN. They make them too big for one thing.

Mr. REUTHER. You are talking about automobiles. I would agree we should have made a small car years ago. There are millions of families that need many consumer goods.

Representative KILBURN. The problem, it seems to me, that we have to face, is that if people lose their confidence in the dollar, not only in this country, but all over the world, we are in bad shape. Anything we do to make them lose that confidence is bad.

Mr. REUTHER. I haven't talked to a single unemployed worker in Detroit who says his problem is loss of confidence. Everyone tells me his problem is loss of his job.

Representative KILBURN. Of course, you try to meet the problem of maintaining confidence in the dollar in order to help that employed man get a job.

Mr. REUTHER. I think the Federal Government under the Employment Act of 1946, has the responsibility for providing affirmative and bold leadership to find a way to supplement the private sectors of our economy in order to get America back to work.

If you don't do that then you are failing to implement the provisions and responsibilities in that act.

Representative KILBURN. If we have a deficit do you believe in raising taxes?

Mr. REUTHER. Don't you see the size of your deficit is relative to your production? We lost nearly $50 billion last year because of unemployment, underutilization. If we had created that $50 billion we could not only have cut the deficit, we could have made a contribution toward reducing the overall debt.

It is the loss of the $50 billion that is the source of our problem.

Representative KILBURN. They would have had the production, of course, if they could have sold it.

Mr. REUTHER. This gets back to this chart——

Representative KILBURN. I am sorry, but my time is up.

Mr. REUTHER. I will take a minute of somebody else's time. You say the people didn't buy the goods. Why didn't they buy them? It is because the people who had more then they needed got more than their share and the people who needed more were denied their fair share. The consumers and workers of America have been shortchanged in the very period when they are being blamed for inflation.

You explain this chart to any G.M. worker and make him believe that he has caused the inflation.

The CHAIRMAN. Congressman Bolling.

Representative BOLLING. I so largely agree with what Mr. Reuther said that I want to pass.

The CHAIRMAN. Senator Sparkman.

Senator SPARKMAN. I unfortunately was late and did not read the whole statement. I will pass.

The CHAIRMAN. Mr. Widnall.

Representative WIDNALL. Mr. Reuther, this is the second time I have heard you testify and I have to admit it always sounds like the Sermon on the Mount.

I wish sometimes in the broadcasts sponsored by AFL-CIO there was a little bit more of that spirit because I find that they are sometimes, in my opinion, viciously calculated to stir up envy and hatred in America where I feel there is no place for it.

I think the spirit that you speak about in your address before the committee, the one that we should have in this country, the one that you say you would like to see, between management, labor, and the consumer, is not helped by some of the political action of your own AFL-CIO.

Now, do I understand by your constant reference to the Russian economy as against the American economy that you are advocating the same type of austerity they are practicing over there in order to get this done?

Mr. REUTHER. It is quite obvious that I am not proposing we do anything like the Soviet Union. Since we have all the resources we need, the technology, the plant capacity, we have the ability to grow at a faster rate than we have actually been growing. I am merely proposing that we act as a sensible, rational society of free men, motivated by the common objectives we all share, and find a way to achieve this greater growth.

Now, the Soviet Union gets it at a tremendous cost, but we can get it with 5 percent growth.

There is no question about it. The Rockefeller committee—and I don't think Mr. Rockefeller can be accused of waging the class struggle or proposing to do what the Russians are doing—the Rockefeller report talks about 5 percent.

They use a different base of projecting the figures of growth compared to the Soviet Union than I have used, but they come out essentially the way I have come out.

All they say, and all I am trying to say is that we have the resources, we have the know-how, we have the manpower, we have everything; all we need is the will and the sense of urgency to commit these resources to the kind of realistic economic program that will get America back to work. In the long pull you can solve an economic problem not with propaganda, but only by rational economic action and hard work.

That is what we are proposing to do. Not a worker unemployed in America, not one in a million, wants welfare. What he wants is the opportunity to earn a livelihood for his family.

Representative WIDNALL. I do not think there is any dispute about that. Sometimes people seem to feel this is a dispute about that. But there is an honest difference of opinion as to how you obtain that with the best result to everybody, including the retired people, the pensioned people, and others who are very much within our economy.

When you compare percentages of growth, in Russia, for instance, don't they have a much higher potential for growth in the sale of automobiles than here in the United States? Have we not the ability to produce right now in the automobile industry for every person who wants an automobile in this country, while in Russia you have unlimited potential consumer impact on the market, and if their production goes up from 1,000 a year to 2,000 a year they have increased their automobile production 100 percent while ours may have gone down a percentage point?

Mr. REUTHER. Yes, sir; but this question of the growth in our economy is much more fundamental than how many automobiles we make. It deals with the whole question of steel, petroleum, basic resources, development, and so forth.

I am not prepared to sell America short by saying we have everything we need and therefore we don't need this great effort. We need this great effort. We need it desperately. We cannot permit the Soviet Union to expand at 7 or 8 percent a year while the American economy limps along at 2 percent. Ultimately, we are going to be unequal to this challenge.

Representative WIDNALL. Mr. Reuther, you made specific recommendations with respect to Federal tax revenues to repeal certain laws, and require withholding of taxes on payments of dividend and interest.

You also say, repeal excessive depletion allowances such as those on oil and gas and remove such tax privileges from many of the metals and minerals now covered.

As a realist, Mr. Reuther, how much Government expenditure do you think we dare make on the prospect that this depletion provision will actually be changed?

Mr. REUTHER. Economists estimate the increased revenue that would flow from the implementation of our recommendation to be about a billion dollars. We think that there are loopholes in the Federal revenue bill that could be tightened up, that would yield considerable increased revenue to the Federal Government and we believe that the tax structure would be more equitable after these things will have been done.

Representative WIDNALL. As to point 4, you say: "Tighten the capital gains structure by lengthening the holding period for long-range gain and increasing the current 25-percent tax rate." You previously referred to the inflated stock market today; is that not largely due to the reluctance of people to sell and pay the high taxes they now have to pay on capital gains? And if you increase the length of the holding period and increase the percentage of tax, you will have people buying stock and holding it.

So things automatically go up. If anybody wants to buy stock in the future, they run into owners who cannot afford to sell.

Mr. REUTHER. We don't agree with that point of view. We don't think this is where the impact of stock market prices occurs.

Representative WIDNALL. That is all.

The CHAIRMAN. Congressman Reuss.

Representative REUSS. The President's Economic Report includes a chart showing that about 25 percent of our industrial capacity is unused. The report also states that unemployment is on the order of 6 percent of the work force.

If by reason of a more purposeful program the unemployment rate were halved, let us say, have you any estimate of the percentage of unused manufacturing productive capacity which would be absorbed?

Mr. REUTHER. I think a reduction from the current level of a little more than 6 percent down to 3 percent would get some of the idle capacity back into operation obviously, but just getting idle capacity back to work will not solve the job problem because you have this continuous pressure of technological advances.

I think at the present we are not even providing for displacement, let alone beginning to take care of the growth in our labor force.

Representative REUSS. Thank you.

The CHAIRMAN. Thank you, Mr. Reuther.

Mr. REUTHER. Thank you, Mr. Chairman.

The CHAIRMAN. The next witness is Mr. Walter Fackler of the department of economic research of the Chamber of Commerce of the United States.

## STATEMENT OF WALTER D. FACKLER, ASSISTANT DIRECTOR OF ECONOMIC RESEARCH, CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. FACKLER. Mr. Chairman, I am Walter D. Fackler, assistant director of economic research of the Chamber of Commerce of the United States.

I feel flattered by such a large turnout of the committee this morning, and such a large gallery. I have not been so blessed before in my previous appearances.

Mr. Chairman, I am here at the invitation of the committee, representing the national chamber, to discuss the Economic Report of the President and issues relating thereto.

Like its predecessors, the 1959 Economic Report can be both praised and criticized. It contains much helpful analysis, most interesting, factual information, and a very useful collection of statistical data, but it also has shortcomings which detract from its usefulness.

Like those of previous years, this report is cluttered and encumbered by a lot of discussion of sociological problems and many recommendations of a welfare nature, which, however important in themselves, are related only indirectly to the central problems of economic stability and growth. This is unfortunate for two reasons:

1. It obscures the main issues of general stabilization policies and diverts discussion to subsidiary issues which should be handled on their individual merits in other legislative forums; and

2. By injecting all sorts of subsidiary and often controversial issues into the debate, it arouses apprehensions, creates unnecessary divisive argumentation and widens disagreements on basic policies where we should be seeking greater understanding and unanimity.

Let it be clearly understood that we are not singling out this particular report for special criticism; we are merely reiterating objections made in previous years and making another plea for more directness and more relevance.

We badly need, it seems to me, to get more agreement and unanimity on the fundamental problems of economic stabilization; and we could do this, I think, if discussions were not complicated by so many side issues which, in the nature of the case, are bound to be controversial.

The President quite rightly continues to stress the long-run inflationary problem. We may agree or disagree about the gravity of the immediate inflationary prospects; perhaps, they have been somewhat exaggerated. But few deny that we face an uncomfortable long-run problem of "creeping" or ratchet or secular inflation which we will have to learn to control or learn to live with. As a Nation we seem to be dismayed at either prospect. We seem to be irked by social discipline necessary to control inflation; yet, we are distressed by what chronic inflation would do to our economic system.

We do not attempt here to analyze the nature of the complex causes of inflation, or to assess the relative strengths of various inflationary biases at work in our economy. But we would like to commend the President's report for its explicit recognition that Government policies are fundamentally responsible for inflation, if it persists—appeals for voluntary private restraint notwithstanding.

The Government is responsible, under the Constitution, for monetary management. Government spending, taxing, and debt policies have an enormous influence on prices and production. The price rigidities pushed into the system by Government regulations, subsidies, protection, and price fixing, taken in the aggregate, probably constitute, by far, the greatest inflationary bias we have. Monopoly power in product and labor markets is a proper concern of public policy, but largely for reasons other than inflation. As a possible source of inflationary pressure, private market power pales into insignificance alongside the inflationary engine that is Government.

The administration is to be commended for the establishment of a Cabinet Committee on Price Stability for Economic Growth to study and review the general problem of prices and growth. But more important, it should be commended for setting up a Committee on Government Activities Affecting Prices and Costs to scrutinize relevant Federal programs, such as procurement, construction, stockpiling, subsidies, price supports, etc., for their inflationary potential. Surely, the Congress should follow this example.

It does not seem sensible for the Congress vigorously to pursue inflationary "scapegoats" in the private sector of the economy when, through a host of programs and activities, it continues to tolerate, create, and justify many of the most serious inflationary pressures we confront.

The Joint Economic Committee has a clear responsibility to point out this inconsistency to the Congress and to try to induce the Congress to take a more comprehensive and understanding view of the governmental role and responsibilities in these matters.

We strongly support the President's recommendation that the Employment Act of 1946 be amended to include reasonable stability of the general price level as an explicit goal of public policy. If preservation of purchasing power of the monetary unit is not made a coordinate goal with maximum employment, at least it should be made a constraining goal to condition the means by which the primary employment goal is pursued.

Of course, amending the Employment Act would not, in itself, curb inflation. It would have to be implemented by consistency and rationality in other governmental policies.

Some people will say such an amendment is unnecessary or that it would have to be so vague as to be meaningless, or that it would stress price level stability at the expense of maximum employment. These objections are, by and large, specious.

There is much to be said for stating our basic goals of economic policy explicitly. If there are conflicts (and some conflicts and compromises are inevitable), they should be openly faced and the alternatives honestly posed. As to vagueness, this charge is equally true of other policy goals. And necessarily so.

We cannot define "full employment" precisely. Indeed, we must expect "normal" unemployment to vary from one time period to another and from one set of economic circumstances to another. As for subordinating employment goals to price level stability goals, this is simply a matter of policy implementation—not of the goals themselves. If pursuit of one objective unduly jeopardizes the attainment of others, we should blame the Congress and the administration, and not reject a positive affirmation of principles which we profess to believe.

On one aspect of anti-inflationary policy, we disagree with the President. Perhaps exhortations to consumers, businessmen, and labor leaders to exercise restraint in buying, pricing, and bargaining have some public relations value. Moral suasion should not be dismissed out of hand. But the implications of such injunctions are somewhat disturbing. In essence, they say to the businessman and labor leader—do not behave as competent businessmen and union officials; do not respond to the normal and legitimate economic incentives; do not manage your affairs efficiently.

To tell consumers to shop wisely is good advice, but it is not likely to be an effective anti-inflationary policy measure.

Our system depends on people, individually and through organized effort, pursuing self-interest in economic affairs. It depends on competition as the major and ultimate agency of social control to harness self-interest to the public good. To admonish self-restraint presupposes that business and labor organizations have sufficient economic power to generate autonomous inflationary pressures. This has not been proven to the satisfaction of most economists, Mr. Reuther notwithstanding.

But if this power does exist, then the report should have attempted to establish the case by careful analysis of the relevant evidence, then proposed policy measures appropriate for dealing with the problem. Surely vigorous enforcement of competition would be a wiser policy than to call for voluntary private restraint or to threaten possible imposition of price and wage controls. Direct controls would be uneconomic and probably ineffective. Moreover, they would change the fundamental character of the economic system.

The "Economic Report" rightly stresses economic growth as a desirable and necessary goal. While we do not agree with some of the specific recommendations of the report, supposedly designed to promote economic growth, the basic orientation is sound.

There is much wringing of hands these days about our growth rates vis-a-vis the rates of economic growth of the Soviet bloc. The Soviet challenge is a serious matter, as this committee knows, and it should not be taken lightly. The challenge is more than political and military; it is also ideological—a challenge of freedom as well as growth. Can an economic system which allocates its resources in response to free consumer choice, free occupational choice, and free investment decisions, which relies primarily on voluntary savings and private initiative and incentives for its direction and rate of growth—can such a system survive the threat of the growing economic power of an authoritarian system, a planned economy where little individual freedom exists, politically or economically? At the same time, can we, through democratic processes, provide collectively the public investments and public goods necessary to maintain adequate defenses and to meet most urgent free social needs without destroying the character and viability of the system being challenged?

In short, do we want growth dictated and directed by Government, as in Russia, or growth which steps from the creative energies and thrift of a free people?

Much of the talk of growth and productivity these days is irresponsible, however sincerely intended. First, comparisons of growth rates of the United States with those of Soviet Russia too often degenerate into an infantile numbers game. Changes in output per man-hour or gross national product do not adequately measure growth in productive capacities—especially, when we do not take into account such things as labor force propensities, working hours, relative factor endowments, and the composition of the output being increased in the different systems. Nor is it admissible to compare directly rates of growth and acceleration of rates of two economies in different stages of historical development at any given point in time.

What does it mean, for example, to say that Soviet agricultural output is increasing rapidly, when we are trying to reduce ours? What does it mean to say that Soviet steel capacity is increasing more rapidly than ours, when our expansion is taking other forms? Yet, it is not unusual to see in public statements frightening extrapolations of Sino-Soviet growth based on accelerating rates of change, or the rapid expansion of particular lines of production.

Second, many of the prescriptions for improving our own growth performance are naive or seem designed to inhibit growth. We are told, for example, that growth is largely a matter of "budgeting up" to potentials, that we need to maintain very low interest rates by substantial inflation of the money supply, or that we need more Government controls to force savings and channel investment "wisely."

Indeed, "growth" has become a popular catchword used to justify any scheme of Government spending, any degree of fiscal and monetary looseness, and many kinds of governmental intervention into private economic affairs. On grounds of growth, paradoxically, many people suggest that we should subsidize declining industries, insulate producers, workers, or regions from economic change, reduce mobility of labor and capital, and divert resources of low productivity investments away from those which would yield higher real returns to society.

Economic growth is a process which involves the shifts of resources from one use to another. It also brings about many revaluations of different kinds of resources. Not all sectors of the economy can, or should expand evenly; nor can we expect productivity improvements to be the same in all lines of production. Substantial changes in the composition of consumer demand and output are bound to take place, as the economic history of this country amply demonstrates. Certain future changes can be predicted with some degree of confidence; others cannot. But on the basis of past experience, we can predict that growth will often conflict with the security or opportunities of particular groups within the economy. And we can predict that as economic change takes place, a host of public measures will be advocated to stimulate "lagging" sectors, to block the necessary shifts of resources, and to prevent the market from revaluing resources to reflect relative scarcities.

Of the thousands of bills already introduced in this session of Congress, it is probably safe to estimate that over 50 percent of them have growth retarding features. In its report, the Joint Economic Committee could perform no more useful service than to analyze the significance of the Government's true posture toward economic growth and change.

All this is not to say that certain public investments, Federal, State, and local, in public works, education and research are not important elements of balanced economic growth. Nor do we condone using "inflation" as a club to beat down necessary public programs or sustainable private investment. Nor do we minimize, for a moment, the threats and dangers posed by the rapid economic development of Soviet Russia.

What we do say is that as a Nation we are behaving in an unrealistic and inconsistent manner. While growth is acclaimed as an urgent necessity, there is a reluctance to accept growth or do the things on which it depends.

Growth within a context of economic freedom cannot be simply dictated by Government, as some would have us believe. If, in our anxiety, we adopt the Russian devices of direction, planning and control, Khrushchev would, in fact, win his challenge hands down.

If we are really serious about growth, as we should be, we should consider, as carefully and objectively as partisanship will permit, the question of what the proper role of Government should be in promoting growth. What should the Government do? And not do?

The basic function of Government in promoting is twofold:

(1) To provide and maintain an economic climate conducive to growth—a climate in which private initiative, innovation and creativity would flourish; and

(2) To provide complementary public services desired by the public which Government can best provide.

In addition to reviewing and eliminating many growth retarding Government activities, probably the biggest step toward creating a sound growth climate would be to overhaul our tax structures. The present Federal tax system is punitive and wasteful. It discriminates against initiative and risk, and it impedes the mobility of venture capital. It helps to destroy State and local fiscal capacities.

But we put off each succeeding year tax reform because of the pressing revenue requirements. We can never start tax reform, unless we start. In addition, we bicker endlessly over the distribution of tax burdens, which are now distributed capriciously and arbitrarily. As a result, any attempt to evaluate our tax system objectively or "rationalize" it meets anguished outcries of those who want special treatment or who make a profession of deluding large masses of people into believing that they can have something for nothing.

Our democracy in action has hardly had a distinguished record on this score. Our political helplessness would be amusing if it were not appalling.

If we want growth and, at the same time, want to preserve a Federal system of National, State and local governmental units which is or should be responsive to a diversity of needs and preferences, we must vigorously and courageously pursue new approaches to the problems of intergovernmental fiscal relations. We must preserve scope for local initiative and fiscal capacity at the local level for meeting public wants and dealing with community problems which do not require a standard national product or a standard national solution.

Our present specific grant-in-aid approach is horribly wasteful and appears admirably designed to frustrate the will of the electorate. In spite of the administration's attempts to release both functions and revenues from the hands of central government, the tide runs too strongly in the other direction. Yet, for economic growth, we badly need vigorous State and local efforts to provide vital educational and community facilities and to cope with essentially local problems. Here is a great challenge to imaginative thinking and statesmanship.

Discussion of our growth prospect and problems would be seriously deficient without some mention of financing. The "Economic Report" should analyze in more detail the general financial outlook for the year ahead and should discuss much more thoroughly the fiscal and monetary arrangements necessary to meet private and public financial needs in a growing economy.

Obviously, the details and timing of specific monetary and debt policies cannot be predicted, decided or published in advance; but the general rules of the game should be made known, including implications of the proposed budget for monetary policy and debt management.

A forthright, consistent integrated statement of financial problems and plans would do much to eliminate unwarranted criticisms of monetary policy and enable both public and private agencies to plan their financial operations with more confidence and efficiency.

It is of crucial importance for the public, the Congress and all governmental officials to realize that voluntary savings are the main source of funds available for net capital formation. If the Government cannot cover expenditures by tax receipts, it must borrow voluntary savings or ask the banking system to monetize new debt instruments—in essence, to print money.

If the Government borrows voluntary savings from the capital market, it must pay market rates of interest and compete directly with private investment for the use of funds available. Creating new money by having the central and commercial banks monetize deficits may be highly inflationary.

It is certain to be, if the total monetization of both private and public debt increases the money supply faster than reasonable growth expectations justify.

There is no such thing as an "uncovered" deficit in periods of relatively high employment. If Government deficits are financed at artificially low interest rates by excessive monetary expansion, we tax by inflation. In which case, the low interest rates are essentially fraudulent.

The control bank can influence both monetary and real rates of interest, but it cannot determine the real rates. The real rate depends on willingness of the public to save and pay taxes in relation to the demands of Government and investors for real resources.

Furthermore, the Congress should realize that attempts to circumvent reality by low-rate loans, guarantees, and direct public investments, often divert resources from other public and private investments which would, presumably, yield to society a higher real rate of return. Such programs are often antithetical to economic progress.

The President has submitted a balanced budget. This is good economic sense. If we cannot balance our budget in a period of rising prosperity, we might as well just stop talking about adapting fiscal policy to stabilization requirements.

A balanced budget for the fiscal year 1960 (though the balance is precarious) should be strongly supported by all those people both in and out of Congress who last year were advocating compensatory Government spending as an antirecession measure.

One of the serious deterrents to develop in a rational approach to fiscal measures for economic stability is the inconsistency of those who cry the loudest for Government action to combat a cyclical downswing, but are curiously opposed to applying precisely the same principles during the upswing.

(Let me say parenthetically that I know from very bitter personal experience that this double standard is a major problem in educating businessmen and others about the fiscal necessities of economic stability. They simply say we don't believe it. Fiscal measures won't be consistently carried out; they will be a one-way street to ever-expanded Government expenditures. This is the stumbling block we hit time after time.)

The Joint Economic Committee could enlarge public understanding and public support for reasonable and rational stabilization procedures by insisting on fiscal integrity in these matters.

The lack of adequate budget procedures and controls continues to be a major stumblingblock both to true Government economy and rational fiscal policy. Congress seems unable or unwilling to establish priorities and ceilings or to view the budget as a whole.

In the public sector of the economy, the budget is, in a sense, a marketplace where costs should be balanced against benefits and where less essential activities should give way to those which are more essential.

Under current budgetary and fiscal procedures, there is no overall consideration given to the budget by Congress. The expenditure program is considered in a series of 12 to 15 separate appropriation bills which are dealt with and passed upon at different times. None of the spending bills or any spending program is considered in relation to the amount of estimated revenues or to the debt implications.

The entire gamut of budgetary actions—authorizations, appropriations, revenue bills—taken by Congress is conducted in a fragmented fashion by different committees at different times.

The national chamber has recommended that Congress provide itself with a center of financial management in which all budgetary and fiscal activities could be considered as a whole and in relation to each other.

In addition, there is, in the Congress, no adequate policing of so-called public debt transactions by which Congress authorizes outlays of public funds to be borrowed by government or private agencies from the Treasury—additional funds which the Treasury does not have and must, in turn, borrow or draw from the general fund. To authorize disbursements, in the form of Treasury "loans" or "advances" without appropriation and without making any effort to provide such funds by taxing or adding to the Treasury's borrowing authority is virulent fiscal irresponsibility, however good the purpose or noble the motivations for such actions.

The national chamber recommends that these back-door expenditures be brought under proper appropriation and budgetary controls.

It has long been noted that without adequate budgetary evaluation and control, national fiscal policy for purposes of achieving greater economic stability is impossible. The Joint Economic Committee has naturally evinced a great deal of interest in this problem in the past. Because of its special responsibilities, the committee has a great stake in pushing for budget reform.

I would like to emphasize this point. Until we have adequate budgetary procedure in Congress, how can we adapt fiscal policy to stabilization needs? How can this committee discharge its responsibility in these matters? I don't know. I would hate to think that these exercises were a waste of time and energy.

Part of the budget problem in the year ahead is really a problem of debt management. The Treasury faces enormous funding difficulties in handling the existing debt. As debt gets shorter and shorter, more of it must be continuously refinanced. But the market for Government bonds is thin and almost nonexistent.

Even if the market were strong, no really substantial amount of short-term debt could be converted to long-term debt because of the sheer size of the floating debt and private demands for loan funds. To attempt a substantial funding would compete with private borrowing and drive interest rates higher than Congress would be willing to pay—higher than statutory rate limits.

That the Treasury wants to avoid trying to raise new money to cover new deficits is a sensible and understandable position. The Congress, which is largely responsible for the Treasury's position, should give constructive support to the administration in its efforts to maintain a position of financial integrity.

As private spending grows, the debt problem will become more acute. It is quite likely we may have some inflationary refinancing even without any new deficits. If the Congress does not exercise spending restraint, it cannot avoid responsibility for the consequences. It will make a mockery of the statement we so often hear that "We can afford what we need."

This statement is undeniably true, but it becomes meaningless unless the costs and alternatives are evaluated in a rational manner, unless a realistic system of priorities is rigorously established, and unless tax revenues are provided to carry out the spending plans.

The CHAIRMAN. I think we have about 10 minutes for examination of Mr. Fackler.

Mr. Bolling.

Representative BOLLING. Mr. Fackler, in your statement you mentioned the many rigidities that the Government, the Congress, has put in the economy. Would you mind mentioning a few besides the very obvious ones, certain kinds of credit, certain subsidy programs which have been much discussed, the farm program?

Mr. FACKLER. The farm program is, of course, very large. Mining programs are another. All kinds of tariff protection when industries are hurt by import competition is certainly another. It seems now that anyone hurt by import competition is defense essential and therefore entitled to support.

This is a political problem. Almost anyone, if he looks around, can see myriad examples. All I can say, Mr. Bolling, is look to your own district, and this is not meant in a critical way. I don't know what your particular problems are, and I am sympathetic with the problems each of you must face in your own district, but when constituents are hurt by competition or by economic growth or by economic change, there will be tremendous pressures built up here in Washington, as you are very much aware.

Representative BOLLING. I am very well aware of that.

My own particular problem has to do with water resources, but I am interested in getting a listing in the record of some of the many subsidies that are so seldom mentioned.

Mr. FACKLER. I would be pleased to submit a list for the record rather than to give an offhand answer. To rely on my memory might be unfair. I am sure quite a catalog could be compiled.

Representative BOLLING. This is intervention by government at the request of a very substantial segment of the community. I would guess it would turn out to be all the community if you examined it carefully, business, labor, financial, each in their own particular interest.

This is management of the economy upward. Now, my point is an obvious one. If this is bad, and I suspect it may be, then is there anything different in kind from an attempt by government to have its left hand working against its right hand?

This has something to do with inflation as I think you pointed out. Is there a difference in kind? Would it be more improper for government perhaps to indulge in extremes that were used in World War II of allocations and controls?

Mr. FACKLER. It seems to me there is a good deal of difference in degree. In some cases there is a fundamental difference in kind. I am not saying that all subsidies are bad. There may be a perfectly good public purpose in a certain kind of subsidy where we grant the subsidy with our eyes wide open, knowing full well it is going to cost us, in spite of its being costly, we go ahead and do it for a particular social purpose.

I am not saying that all subsidies, per se, are bad; but I do say that the Government has created a tremendous number of price rigidities by subsidies and regulations where costs have not been properly taken into account.

We don't want prices to fall because people get hurt, so we favor those affected by various devices. You say this is a form of price control. It is, certainly. But it is not direct and systematic; so there is a big difference, it seems to me.

A systematic kind of government control where prices are fixed, where wages are controlled, both up and down, is, in many ways, quite a different matter.

Again, I am not saying these other indirect controls are necessarily good, either. There are a lot of them that we should get out of the system.

Representative BOLLING. The thing that bothers me is that I don't see the difference in the type of intervention. It seems to me it remains an intervention which impairs the operation of the theoretically free economy. I cannot find this profoundly different than the other kind of intervention.

Mr. FACKLER. Yes; I think on this score you are wrong, sir. There is quite a difference in kind. It is one thing to say that every governmental program has some economic effects. They all change the distribution of the allocation of resources and the distribution of income.

But people are still free to make their own economic decisions. When you take the economic decision-making power away from the people, you have another kind of a situation—an arbitrary exercise of police power.

Representative BOLLING. I would disagree on the simple question of tariffs. It seems very clear to me that the imposition of a tariff deprives the person who might be competing with the industry that is hurt.

Mr. FACKLER. It may pick your pocket, but it is not nearly as pernicious as a quota or an embargo where you are not allowed to import or buy at any price.

Representative BOLLING. It seems to me it takes away the economic freedom of the person who is not benefited by the tariff imposition. It destroys his position entirely. It seems to me it is just as unfair.

Mr. FACKLER. I did not say it was fair. Of course, it is unfair.

Representative BOLLING. That is all, Mr. Chairman.

The CHAIRMAN. Senator Sparkman.

Senator SPARKMAN. Mr. Chairman, I am going to have to leave very shortly. I hope that either Mr. Fackler or Mr. Robey will give their interpretation of this chart that Mr. Reuther has. This is a rather impressive chart, coupled with Mr. Reuther's statement, and I would like to know what the answers to it are, if there is an answer.

Do you care to comment on it, very briefly, Mr. Fackler?

Mr. FACKLER. I don't understand it. I don't know what his figures mean. I don't know whether they are correct. All I see are two lines.

I would have to try to figure out what is involved and to look at the data behind the chart before I could evaluate it. Offhand, I don't think it is a very meaningful chart, but I prefer not to comment on it. It appears to be one of those striking things similar to the kind used in the steel hearings last year where profits per man-hour of labor input had gone up 1,200 percent, or some such figures, while wages per man-hour had only doubled.

Of course, it may be true, but it is irrelevant to inflationary or other economic issues. Take a case where productivity is increasing, where fewer man-hours are required to produce a given output. Take an extreme case where you have installed almost complete automation. Suppose only 1 man-hour were required to operate a whole vast enterprise by pushing a button. The profits per man-hour would be fantastic, you see. Yet profits still might be low, normal, or high as a rate of return on investment. So of what relevance is such hocus-pocus to the price-wage problem?

I really should not prejudge Mr. Reuther's chart; but, frankly, I suspect it is a gimmick—the same kind of gimmick that has been used in these arguments so many times.

The chart is probably another kind of numbers game. It looks impressive; and you can hang a lot of oratory on it; but it is likely to confuse rather than enlighten.

Really, I would prefer to go back into his data and methods before I comment specifically.

Senator SPARKMAN. Mr. Fackler, you do not touch on this in your statement, but I have often wondered if actually we do not need a better system of bookkeeping in our Federal establishments.

Mr. FACKLER. You mean statistics?

Senator SPARKMAN. No; the method of bookkeeping in separating what might be called capital investments from expenditures as far as our budget is concerned.

Mr. FACKLER. You are taking a very sensible kind of position. But there are arguments pro and con, Senator.

The point you are making is that the budget is misleading because it does not separate out what are current operating expenses from what really are social investments. In the long run social investments are going to increase, presumably, productivity and output in the future; in other words, they will yield a future flow of benefits to society.

Lack of clarity is, to be sure, a serious deficiency in the budget; and those who advocate separating out current operating expenses from capital expenditures by some form of capital budgeting have several good arguments. At least such a procedure explains the budget to the public a little better. It lets them see what kinds of expenditures are being made, which is just as important as the total amount being spent. But there are those who argue, on the other hand, that such procedure is essentially meaningless.

You see, if you separate a capital outlay for a highway—and this is obviously a capital expenditure—what do you do about current operating expenses that go for education? Isn't education, in a sense, just as much a social investment? You get into complex problems of classification.

Senator SPARKMAN. If I were going to draw a line I would draw it between money that is spent and is gone and is not actually going to be repaid, and loans or investments that are to be repaid or remain assets of the Treasury.

Mr. FACKLER. I see no objection to having those items spelled out to the public so that they would better know what is in the budget.

You are really talking about self-liquidating kinds of expenditures, are you not?

Senator SPARKMAN. Yes.

Mr. FACKLER. The expenditure may be productive or unproductive, but it is going to be self-liquidating. That is fine, but funds must be provided for the original outlay.

Senator SPARKMAN. You have something to say about Treasury loans and there is a good bit of discussion about that in the Congress right now. That is outside the budget; isn't it true that most of those loans, most of those outside the budget expenditures are in the nature of loans that are to be repaid?

Mr. FACKLER. Many of them; yes, sir. But does the public understand what is involved? Has this loan procedure become a device to go around normal budgetary procedures?

Also, does it not mean that we finance our national debt outside the so-called debt limitation? Congress goes through a big "to-do" and holds a big hearing every time it raises the public debt ceiling.

What does this sort of ritual mean when you are financing many Government programs outside the debt limit?

What I am saying is that a lot of the debate over the debt limit is emotional and not very realistic. Debate over the debt limit provides the Member of Congress with opportunity to make a record in favor of economy and financial soundness, however spendthrift he may be. I have no objection as long as the Congress is clear on what it is doing and the public is clear on what is going on—that is the main point.

Senator SPARKMAN. Is it not true with reference to the budget generally? A lot of it is emotional and psychological?

Mr. FACKLER. Certainly. Emotional constituent pressure is part of the process of representative government. The public official has always got to justify himself and his proposals.

If such pressure were lacking, democracy would perish. Even if demands for "economy" are unenlightened—sometimes pleas for government economy are unenlightened—let us not be angry or churlish, because they are made. On the contrary, generalized pressure for government economy makes the system viable. There should always be continuous pressure on the government official and on the Congress: "You justify why you use my money publicly instead of letting me use it privately. Maybe I will get more for it that way. I should like you to prove it."

What if we said, "Do anything you want"? We would be in the position of the Soviet citizens; they have no choice.

All I say is: If pleas for government economy are, in your opinion, unenlightened, say so. That is fine. But don't ever, as representatives of the people, say that these people should not be pleading for government economy. They should keep the pressure on all the time.

Senator SPARKMAN. Thank you.

Representative REUSS. You have presented a very thoughtful paper, and I agree with many of the recommendations you make. A good many others I suggest would be more meaningful if they were not made at a time when the rate of unemployment is in excess of 6 percent.

You do not at any point in your statement come to grips with the problem of the current high unemployment rate. I ask you whether the problem of unemployment today is not one which should engage the very thoughtful consideration of Government under the Employment Act of 1946, and, specifically, whether it is not a problem as important to the U.S. Chamber of Commerce as it is, say, to Mr. Walter Reuther of the AFL-CIO?

Mr. FACKLER. You are quite right, sir; it is a subject that should engage the very thoughtful consideration of the Congress and of this committee.

Here is another emotional area because you are dealing in human values. No matter what you say, you are damned before you start. If you say: "Well, the unemployment situation is not really so bad," you are branded as some sort of inhuman monster and editorials in some of the papers will self-righteously assure the public that is so.

But, actually, the present problem is, if you will look at the three postwar recessions, quite normal. The unemployment rate and the recovery of employment has progressed pretty much according to pattern in this recession.

There has been a very sharp recovery. But reduction of unemployment always lags. I do not say there are not serious personal problems for some of the workers, who are unemployed. I feel as strongly on this point as Mr. Reuther. He is more concerned about autoworkers than I am, perhaps, but I am just as concerned about the involuntarily unemployed worker as a personal matter.

But from the viewpoint of an economist, saying what amount of unemployment is now reasonable or how much is consistent with reasonable price stability, these are different questions. Unemployment as an abstract statistical figure and unemployment as a social problem and unemployment as an economic problem are really three quite different things.

In the present situation the recovery has been pretty much according to pattern, with the reduction of unemployment lagging behind recovery in production.

This is natural. This is because productivity has increased.

Mr. Reuther was quite right this morning when he said part of the lag results from recession shakeout. We get back to the previous peak in output with fewer man-hours. This is all to the good. This is part of economic growth.

The problem is getting unemployed people reabsorbed, perhaps in other lines—not necessarily building automobiles in Detroit, which is something that we overlook.

How do we get surplus people out of Detroit? How do we get this man "with 16 years' seniority, with no possible hope of reemployment in autos in the Detroit area," another job doing something else in Detroit, or in a job outside of Detroit?

This is quite another matter. It takes time, not magic or oratory.

Representative REUSS. Your mentioning the present 6-plus rate of unemployment does not mean that either you or the U.S. Chamber of the Commerce think that we cannot have economic growth without this optimum unemployment rate?

Mr. FACKLER. No, sir; I don't know what the optimum unemployment rate is. I do know this: If you are going to have growth, you are going to have rapid exploitation of technological advance and you are going to have major shifts in the composition of consumer demand. As a result, the amount of unemployment that would be normal is going to increase.

In other words, there is no magic figure, in spite of the fact that 4 percent has pretty well been adopted by the press and the public as a sort of unofficial norm.

One of the problems of growth is going to be a rise in normal or frictional unemployment. The question of what, in a rapidly shifting economy, is a realistic unemployment goal is one which we cannot evade. And I do not say this to minimize the problem of unemployment.

Representative REUSS. Thank you.

The CHAIRMAN. We are much obliged to you, Mr. Fackler.

The next witness is Ralph Robey, economic adviser, National Association of Manufacturers.

## STATEMENT OF RALPH ROBEY, ECONOMIC ADVISER TO THE NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. ROBEY. The latest "Economic Report" of the President is, in my opinion, the best in the series of such reports since enactment of the Employment Act of 1946. It proceeds from a conception of national economic objectives which is better balanced, more comprehensive, and more clearly stated than in any previous report. Although the inclusion of price stability as a specific objective is not a new thought, it here permeates the approach to all economic questions to an unprecedented degree.

In addition, this report recognizes, more forthrightly than ever before, the nature of the chief current obstacles to the attainment of those objectives. It emphasizes the damaging economic effects of excessive labor-cost increases, deficit financing, and restrictive taxation. Thus this report is a long step toward a realistic and sound approach to the economic problems of the day.

Since I have no important exception to take to the basic economic philosophy set forth in this document, my comments will be devoted mainly to an appraisal of current economic development.

Throughout the report there is constant emphasis on "reasonable price stability" as an objective of equal importance with the promotion of maximum employment and production. It is evident that this is more than mere lipservice, as in so many other politicoeconomic statements. A devotion to this objective is evident throughout the report.

I endorse the proposal that the Employment Act of 1946 be amended to make price stability an explicit goal of Government economic policy. Too often the act has been interpreted, unjustifiably I believe, as directing the Government to pursue inflationary fiscal and monetary policies in periods of unemployment as a means of increasing demand, with no consideration of whether an insufficiency of demand is the real root of the problem. The proposed amendment would specifically rule out this misinterpretation. It would be the symbol of a new maturity in the Nation's approach to its economic problems—a getting away from the naive notion that demand is the key to all economic questions.

The report uses cogent language in describing the potential economic dangers arising from abuse of "the great power lodged in the hands of labor union leaders." It points out that increases in employee compensation exceeding amounts justified by productivity

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growth not only are inflationary but have the effect of restricting expansion of markets, both at home and abroad, and thereby limiting job opportunities.

In this connection the report mentions certain ominous aspects of recent wage developments. First, wage rates continued to move upward during the recession virtually as fast as in the preceding prosperous years. Apparently a business slowdown, even of this magnitude, does not do much to reduce the upward pressure on wages. This is significant since it indicates that the problem is not self correcting, at least not at a price we would be willing to pay.

Second, although both wage costs and prices had been increasing for several years prior to the recession, the increase in prices was not as great as the increase in costs. In other words a part of the increased cost had to be absorbed by business and profits per unit of output actually declined. Such an impairment of profit was bound to have serious effects since it tended to eliminate marginal operations which might otherwise have been profitable and to destroy incentives for expansion.

Just before the beginning of the present century, it was clear that the Nation's business development was threatened by the growth of monopoly powers in the hands of certain persons in some industries. In dealing with this problem no time was wasted in appealing to the monopolists to exercise self-discipline and restraint. Instead a forceful legislative program was adopted for depriving them of their monopolistic power and preventing anyone from developing monopolistic powers of this type in the future. This program is now embodied in our antitrust law.

It is my conviction that a similar program is needed to deal with the economically destructive effects of the monopoly powers exerted in the labor market by union leaders.

We are impressed by the administration's determination, expressed both in this report and in the President's budget message, to achieve a balanced budget in fiscal 1960. The emphasis given to this objective throughout the report indicates clearly that it is more than a mere pious hope.

I believe that the goal of a balanced budget can be reached in fiscal 1960, but only if all those who have a part to play in achieving this objective are convinced of its necessity and attainability. Unfortunately, the President's budget statements have been met in some quarters by expressions of skepticism as to their feasibility and cynicism as to their motivation.

I hope that this mood of defeatism will not be allowed to prevail as Congress tackles the budget problem. If it does prevail, it will surely make its own predictions of failure come true.

The immediate reason for emphasizing the balancing of the budget is, of course, the elimination of the threat to price stability embodied in the acceptance of continuous deficits. But it is important to look beyond this objective and recognize the necessity for making progress toward a major reform of our tax system. Our present Federal tax structure is a major impediment to economic growth both because of its impairment of economic incentives and because of its destructive effects on the sources of capital for expansion.

The President's report recognizes these effects of the tax system and holds out the hope that some progress can be made toward tax reform in the future. This is to the good but one wishes that some concrete program for moving toward a less repressixe tax system could have been announced, at least in outline if not in detail. There is greater prospect of success if concrete goals, rather than mere vague hopes, are set before the Nation.

As a practical approach the association I represent has for some years advocated a program of prescheduled tax-rate reductions, to take effect over a series of years, and based on the increase in revenues which can reasonably be expected from economic growth.

Prompt enactment of such a program would give an immediate psychological lift to both the consumers and investors of the Nation. I can't think of anything which could do more to improve our general economic health here and now. The ultimate effect would be to replace the present repressive tax system with a system under which we can prosper and grow.

Of course as an alternative we can sit back and wait for the economic growth to occur and then set about reforming the tax system to whatever degree is made possible by that growth. But I think you will agree that past experience lends no encouragement to the belief that things will ever work out that way. The difference between the two approaches is the difference between an announced determination to achieve tax reform and a mere hope that it will fall into our laps.

But an even more basic problem is involved. Prospects for tax reform depend largely on the future expansion of the revenue base as a result of economic growth. But economic growth itself depends on a reform of the tax system. The forward-scheduling device offers the only visible means of breaking out of this vicious circle.

When I appeared before this committee a year ago, the economy was in a recessionary downslide. I expressed the view that the immediate difficulty lay in a series of unwarranted increases in labor cost, which had had the effect of restricting markets and squeezing profits. It is my view that this is still the key to understanding developments since last year and prospects for the future.

I am unable to share completely the general tone of optimism reflected in the President's report. The degree to which we can be said to have emerged from the recession depends on the particular statistical series we regard as criterion. For example, contrast the recovery in industrial production with the recovery in employment:

| | Industrial production (1947-49=100) | Nonagricultural employment (millions) |
|---|---|---|
| Prerecession high | [1] 145 | [2] 52.5 |
| Recession low | [3] 126 | [3] 50.1 |
| December 1958 | 142 | 50.7 |
| Percentage of recession drop recovered by December 1958 | 80 | 25 |

[1] August 1957. [2] July 1957. [3] April 1958.

On the basis of production we have recovered all but a small part of the ground lost during the recession. But on the employment criterion we have made only a bare beginning in recovery.

Of course, a more rapid increase in production than in employment is a normal feature of the first stage in business recoveries. The fact remains, however, that our assessment of the extent to which we have emerged from the recession depends on whether we look at production or employment figures.

I do not mean to offer these two sets of figures as an arbitrary choice in measuring recovery. The contrast between employment and production provides an analytical basis for understanding what has happened since the low point of the recession.

The more rapid increase in output than in employment is partly explainable in terms of an increase in the average hours worked per employee. But it seems to be due mainly to an increase in productivity—the average amount of output per employee per hour. It is still too early to measure that increase in precise statistical terms, but its existence is a matter of common observation. Business observers speak of a "tightening up on costs" all up and down the line during 1958.

The improvement in productivity thus indicated is in itself a good thing, especially under present circumstances. Indeed, it is the chief basis for the fact that we have had at least some recovery from the recession. The unwarranted increase in labor cost which led up to the recession of 1957–58 was offset to some degree by the exceptional gain in output per man-hour in the latter part of 1958.

What has happened is this: The reduction in unit costs resulting from improved productivity has meant that markets could be expanded and production increased. But the increased productivity has also meant that the increased output could be produced without hiring many more people.

This type of recovery is better than nothing. However, what we would really like to see is the prerecession levels of employment restored, or rather raised to cover the normal increase in the labor force, with everybody working at the newly attained level of productivity.

The point I want to emphasize is that, if we depend wholly on a gain in productivity to bring us out of a recession induced by excessive labor costs, what we will get is a recovery in production without much gain in employment. For a full-scale recovery from such a situation what we need is some relief from the continuous wage and fringe benefit increases which have plunged us into it.

Let me clear up one possible misinterpretation. Since the gain in productivity means that output has increased at a faster rate than employment, one might be tempted to conclude that, if only there had been no gain in productivity, employment would have increased as fast as production.

Thus it might seem that we would have had an 80-percent recovery in employment, instead of the mere 25 percent recorded. Thus, it might be argued, the improvement in productivity has impeded recovery in employment.

The fallacy in this line of thinking is that, without the gain in productivity, there would have been no offset to excessive labor costs and therefore no recovery in output to speak of.

This also suggests another important conclusion. If the recent gains in productivity are used to support claims for exceptional wage increases we will be right back in the difficulties where we started. If we have had some success in reducing the restrictive effects of high costs by increasing efficiency, let's not cancel that gain out by further unwarranted rises in wages and fringe benefits.

One other factor tends to temper any long-term optimism which might arise from our record of recovery since the spring of last year. A substantial part of that recovery had been due to the coming to an end of the period of inventory depletion.

This development was foreseeable and inevitable; you can't do business indefinitely by selling goods off the shelves without producing new goods to take their place. But this is a temporary stimulus to business and cannot be the basis for continuous future growth.

In the first quarter of 1958, business was producing goods at an annual rate of almost $10 billion less than the rate at which goods were being sold out of inventories. About half the decline in gross national product between third quarter 1957 and first quarter 1958 was due to this depletion of inventories.

Sooner or later you have to get back to a point where you are producing goods as fast as you are selling them. Apparently this stage was reached in the last quarter of 1958. This development by itself accounted for recovery of half the ground lost in the recession. But it is a one-shot affair whose effect in restoring business levels cannot be relied on to carry us very much further.

The President's report contains a paragraph on this subject which is worth quoting in full:

> * * * if we are to achieve a rapid rate of economic growth and improvement in the years ahead, we must continue to enlarge and improve the plant and equipment that supplement human effort and make it increasingly productive. There must be strong incentives for businesses to commit ever larger sums for expanding their operations and reducing their costs. And there must also be incentives for the thrift essential to the financing of these critically important outlays. Policies that weaken these incentives will cause us to fall short of achieving our full potential for expansion.

We are pleased at this explicit recognition of the critical importance of capital formation and of the necessity of fostering incentives for saving and investment.

But there is evidently something seriously wrong in this critical area. It is precisely here that recovery from the recession drop has been most disappointing. The record is as follows:

*Business expenditures for new plant and equipment*

[Billions of dollars, seasonally adjusted annual rate]

| | |
|---|---|
| 3d quarter, 1957 | $37.75 |
| 3d quarter, 1958 (recession low) | 29.61 |
| 4th quarter, 1958 | 29.93 |
| 1st quarter, 1959 (anticipated) | 30.51 |

There was a drop of $8 billion in the annual rate of investment expenditures, during the recession. Through the current quarter only about 10 percent of this loss has been recovered. By contrast, similiar totals of consumption expenditures in current dollars have gone well ahead of their prerecession highs.

It should be a matter of great concern that there has been only a nominal recovery in business investment. Our long-term growth depends on this more than on any other factor. In the present state of world affairs any retardation of our growth in productive capacity and efficiency should not be tolerated.

It seems clear that our poor performance in respect to business capital formation must be explained in terms of two factors already mentioned: the squeeze on profits and on markets resulting from excessive labor cost increases, and the restrictive effects of our tax system.

It is understandable that business investment should be even more sensitive to these adverse influences than production or employment.

Whether we concentrate on the prospects for balanced and complete recovery from the recent recession, on our long-term prospects for a maximum rate of economic growth, or on the possibility of maintaining a generally stable price level, two problems emerge from the analysis:

1. The constant upward pressure on labor costs resulting from the monopoly powers of organized labor. If these increased costs can be passed on they will be reflected in inflation. If they cannot be passed on, the resulting squeeze on profits restricts production and business expansion.

2. The restriction on capital formation resulting from our present tax system.

I cannot take an optimistic view of our longrun economic prospects unless we make some progress in dealing directly with these problems.

The CHAIRMAN. Mr. Bolling.

Representative BOLLING. No questions.

The CHAIRMAN. I have only two brief questions.

A high rate of capital investment was proceeding in 1955–56 and the first part of 1957 when according to your statement labor costs were rising.

The fresh investments are low and not increasing appreciably during the period during which labor cost figures are falling. That would seem to be contrary to the argument that you have been making.

Mr. ROBEY. No; I don't think so, Senator. I think labor costs figures are falling slightly. Of course, we don't have actual statistics on that, as you know. I would think that actually one of the principal factors leading to holding down our present investment in plant and equipment is the shortage of capital. We just don't have the capital at the present time.

The CHAIRMAN. Of course, some of the capital in 1955 and 1956 was created by the banking system where investment exceeded savings.

Mr. ROBEY. In 1955 and 1956 I don't think the commercial banks themselves really took on very much in the way of capital loans—of course, they can't buy equities, so the only thing they could buy was corporate bonds, and I don't think they did much of that.

The CHAIRMAN. That is a question that needs to be proved. The Federal Reserve felt that they were creating investment funds.

The second question I think is a perennial issue when representatives of the NAM come before this committee.

I take it that what you want to have done is to decrease the tax rates on the upper income groups and substitute a sales tax. Is that still the policy?

Mr. ROBEY. No, sir.

The CHAIRMAN. That used to be the policy of the NAM. Have you ceased advocacy of the sales tax?

Mr. ROBEY. We are no longer sponsoring a uniform manufacturers' sales tax.

The CHAIRMAN. When did you stop doing that?

Mr. ROBEY. Now, let me start over again. A uniform manufacturers' excise tax is still on our policy books, but a couple of years ago we stopped sponsoring it as such and started to work on a 5-year tax program, which is our present policy. Now, that 5-year tax program, Senator, is not just on the upper brackets. It goes clear across the income tax scale.

The CHAIRMAN. Do you propose a maximum rate of 25 percent in the income tax?

Mr. ROBEY. No; we do not.

The CHAIRMAN. That at one time was the policy?

Mr. ROBEY. No, not within my knowledge of the NAM have we ever sponsored a maximum tax rate of 25 percent.

The CHAIRMAN. What maximum would you favor now?

Mr. ROBEY. Last year when we were sponsoring a bill, at the end of 5 years if the whole thing had gone through it would have been 42 percent.

Now, that seems to us a little bit higher than desirable, but if we could get down to 42 percent we would consider it a great victory.

The CHAIRMAN. I am sure it would be for you.

Let me ask you this question: If the rates on the upper brackets were diminished, would the NAM support a move to close some of the tax loopholes?

Mr. ROBEY. I remember we discussed that last year. The question is: What do you call a tax loophole?

The CHAIRMAN. I will list some of them. Depletion allowance on oil and gas, sulfur, minerals.

Mr. ROBEY. I told you last year we had merely a general position on depletion. That is all. We do not approve nor disapprove the present figure on oil or on any of the other things. We just say depletion allowance for tax purposes is a sound idea, but we do not go into the details.

The CHAIRMAN. I have a proposal to cut the depletion allowance from 27½ percent to 15 percent for those with gross incomes from gas and oil in excess of $5 million per year. Do I understand that you might favor that proposal?

Mr. ROBEY. Actually in view of our policy let me say again, remember, that there is no committee, no man in the NAM that can talk outside of policy.

At the present time our policy would not permit us to testify either pro or con on your proposal.

The CHAIRMAN. You would not be con, then?

Mr. ROBEY. No; we would not be con.

The CHAIRMAN. There is not con in this testimony?

Mr. ROBEY. No; we would not be either pro or con on that proposal.

The CHAIRMAN. How would you feel on the withholding tax on dividends and interest?

As you know, we have a withholding tax on wages and salaries, but not on dividends and interest. There is a good deal of evasion on this point as Governors Rockefeller and Furcolo have discovered in their State income taxes in New York and Massachusetts.

One Governor has put through and the other Governor is advocating a withholding tax on the State income taxes.

Would you favor the extension of the withholding system by applying it to dividends and interest as well as to wages and salaries?

Mr. ROBEY. I don't think so, and for a fairly obvious reason.

If you withheld an income tax on all dividends, then you are going to withhold more than a lot of taxpayers are going to pay.

The CHAIRMAN. That is true on wages, too.

Mr. ROBEY. Yes, and it causes quite a lot of work and shenanigans to get the return as you know.

The CHAIRMAN. Would you favor the abolishing of the withholding tax on wages and salaries?

Mr. ROBEY. No; I would not.

The CHAIRMAN. You would keep it on wages and salaries, but you would not extend it to dividends and interest?

Mr. ROBEY. We have at least gotten used to it. I don't think there is any real comparability between what is happening on a national scale and what may be happening in New York.

The CHAIRMAN. What about the dividend credit in the 1954 tax?

Mr. ROBEY. We are all in favor of it. We don't think it went far enough.

The CHAIRMAN. I take it you answered the question on capital gains, did you not? Would you propose lengthening the period over which capital gains could be computed?

Mr. ROBEY. No; we did not make that recommendation.

The CHAIRMAN. Would you oppose lengthening the period?

Mr. ROBEY. I would assume definitely, since our position is that the period should be shortened.

The CHAIRMAN. Now, what about family partnerships? The famous case of Payscoff-Tincoff who put his 6-weeks-old son in as a partner in his private accounting firm and split the profits of the accounting firm with his partner and, therefore, reduced his tax.

Mr. ROBEY. You are getting into a detail there that we don't have a policy on.

The CHAIRMAN. It is quite striking. Here is a 6-weeks-old boy who was made a full partner in the accounting firm, although he had not passed the examination as a certified public accountant, and he had no control over the affairs of business. Yet he was made a full-fledged accountant.

Mr. ROBEY. Personally I think it is outrageous, but we have no policy position on it.

The CHAIRMAN. I hope we can get together, Mr. Robey, and get some things we can work on.

Mr. ROBEY. You are talking too much detail for the moment.

The CHAIRMAN. Life consists of details.

Mr. ROBEY. That is for sure.

The CHAIRMAN. Thank you very much.

Mr. ROBEY. Thank you, Mr. Chairman.

Mr. WIDNALL. Mr. Chairman, in line with Senator Sparkman's suggestion that we have an interpretation of the very interesting and provocative chart, which Mr. Reuther introduced, I wonder if we ought not ask General Motors to comment for the record?

The CHAIRMAN. I will see that General Motors is advised of your request.

(The subsequent exchange of correspondence follows:)

FEBRUARY 10, 1959.

Mr. FREDERICK DONNER,
*Chairman, and Chief Executive Officer,*
*General Motors Corp., New York, N.Y.*

DEAR MR. DONNER: At a hearing yesterday on the Economic Report of the President, Mr. Walter Reuther, vice president of the American Federation of Labor and Congress of Industrial Organization, was a witness before the Joint Economic Committee. In the course of his testimony he introduced a comparison between the income received by a hypothetical investor in General Motors common stock and a hypothetical average General Motors worker. The comparison is spelled out in full on pages 25 and 26 in Mr. Reuther's prepared statement, a copy of which is enclosed.

Representative William B. Widnall of New Jersey, a newly appointed member of the Joint Economic Committee, has asked that the comment of General Motors on this comparison be requested for inclusion in the record of yesterday's hearings. On behalf of the committee, I am accordingly writing to you to request such comment. A representative of your Washington office attended yesterday's hearing and is familiar with the discussion which followed this testimony. I trust that we may have whatever statement you may care to provide not later than February 23 so that its inclusion in the record, immediately following Mr. Reuther's statement, may be assured.

Sincerely,

PAUL H. DOUGLAS.

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GENERAL MOTORS CORP.,
*New York, N.Y., February 20, 1959.*

Senator PAUL H. DOUGLAS,
*Chairman, Joint Economic Committee,*
*Congress of the United States, Washington, D.C.*

MY DEAR SENATOR: We have your letter of February 10, 1959, conveying Representative Widnall's request for comment on Mr. Reuther's testimony. I am pleased to give you our views and I shall, in accordance with your request, restrict myself to Mr. Reuther's hypothetical case on pages 25 and 26 of his testimony.

First of all, I should like to point out that Mr. Reuther's calculation of the capital gain which could in theory be realized by a hypothetical large investor in General Motors common stock has nothing to do with the question of new car pricing or price-cost relationships. Second, it may be of interest to you to know that Mr. Reuther's illustrative investor was not typical of General Motors investors in 1947 since in that year only the top one-half of 1 percent of all General Motors shareholders owned such a large number of shares. An even smaller percentage, of course, would have acquired a holding of this size in a single year—in this case, in 1947. Such large holdings are likely to represent stock held by institutional investors or by brokers or others as nominees representing the savings of a great many individuals.

The capital gain which might in theory have been realized under the unusual circumstances postulated in Mr. Reuther's example would result from a combination of factors which were not peculiar to General Motors; notably the general inflation of the postwar years caused initially by the Nation's war financing methods, a resulting tendency over this period for investors to prefer common stocks to bonds, and the confidence of the investing public in General Motors. Common stock prices today are at near record highs as a result of unusually great investor participation in the stock market. The hypothetical capital gain on General Motors stock developed in Mr. Reuther's comparison is attributable in large part to the high level of stock prices caused by these factors.

Aside from the theoretical capital gains assumed in Mr. Reuther's example which are quite irrelevant to his conclusion, we all recognize a very important basic difference between wage income and profit. Wage rates for hourly rated General Motors employees are established by collective bargaining, and are a matter of formal agreement between the corporation and the unions. It is accepted by the unions and management that, in our competitive economy, the rates paid for comparable work are generally substantially the same for all manufacturers in a particular industry. I should say in passing that this same proposition applies to the material and components we purchase. All manufacturers have equal access to the markets at the prevailing competitive prices.

The products we sell are subject similarly to the competitive forces of the market. Prices for equivalent products must be substantially the same if the products are to sell. Since wage rates and material prices are substantially the same for all manufacturers and since prices for comparable products must also be fully competitive, it follows that profits are a residual, rising and falling with the acceptance of the corporation's products in the market and our ability to control costs. Profits are realized only after all expenses of doing business, including the payment of wages, have been met. It would therefore follow that the profits of General Motors are not a cause of the price level, but rather result from the relation betwen the prices determined by competitive market factors and the cost incurred by the manufacturer.

Since wages are a cost, they generally maintain a constant relationship to total dollar revenue. The profit residual, in contrast, varies widely relative to dollar revenue. The most accurate way to show the part played by profits and employee costs in the activities of the corporation is by relating them both to the common base of dollar revenue. For Representative Widnall's information, we have summarized these relationships on attachment A. This information is similar to data presented to a subcommittee of the Senate Committee on the Judiciary at the General Motors hearing on January 30, 1958.

You will observe that in 1958 the net profit reported by General Motors, amounting to 6.6 percent of dollar revenue, was very close to the lowest percentage of any year in the postwar period. This simply means that this net profit, as the residual claimant on dollar revenue, was smaller in 1958 than in most of the postwar years. As a general tendency it will be observed that General Motors profits in relation to dollar revenue declined throughout the period. Conversely, it will be observed that the share of 29.9 percent received by employees in 1958 was exceeded only in one year (1947) during the postwar period, 1947–58.

I need not tell you that the base period selected for a comparison such as Mr. Reuther has made significantly influences the result. Almost any earnings comparison based on 1947 is grossly distorted. In March of 1946 the 119-day UAW–CIO strike against General Motors had been concluded. The result of that strike was a serious delay in the reconversion from wartime to peacetime production in our plants.

The effects of that strike were still being felt in 1947. Moreover, in that year General Motors was unable to obtain sufficient steel and other materials to produce all the cars and other products that could have been sold, due to material controls. Accordingly, both our sales and profit potentials were artificially depressed. Dividends declared in that year, reflecting these facts as well as the financial needs of the business, amounted to $0.50 per share (based on the present $1⅔ par value shares). This was only 3.8 percent of dollar revenue. If we were to compare the course of the stockholders' share of dollar revenue with the employees' share from 1936 to 1947, it would be observed that the stockholders' share declined by about 53 percent while the employees' share increased about 18 percent. Or, if we were to consider the year 1958 relative to 1950, it would be observed that the employees' share rose from 25.7 percent to just under 30 percent while the stockholders' share declined from 11.0 percent to 6.6 percent.

As you will observe from the attached table, the profit residual has been partly distributed in dividends and partly reinvested in the business. The reinvestment of earnings has made a significant contribution to the growth of the business and to employment. In addition, however, it was necessary for the corporation to obtain outside capital twice in 1946, again in 1953, and again in 1955. As a result, General Motors was able to expand its employment from 387,000 in 1947 to 520,000 in 1958 or about one-third. Over the same period our total payrolls rose from $1,175 million to $2,688 million or an increase of 129 percent. In 1947 it took $8,000 and in 1958 almost $19,000 per employe, to underwrite a job in General Motors; that is, to provide the necessary working capital, buildings, equipment, and machinery so that the employee can be properly equipped to perform his job.

We all take great pride in General Motors' postwar record of growth whether measured in terms of dollar revenue or unit sales. The public acceptance of General Motors' products is the best evidence I can offer of the fact that the values offered—the product-price combination—have met fully the tests of competitive markets. It is the increase in volume of sales that has largely made possible the impressive increase in payrolls to a level which, in 1958, was more than double, in fact, 129 percent above, the 1947 level. Our ability to grow in the future and to provide thereby an even larger number of job opportunities is directly related to our ability to produce products at prices which are competitive and at costs which make continued investment in General Motors attractive.

General Motors employees have been well paid by almost any standard of comparison which may be selected. Average hourly earnings of General Motors wage earners in the United States have consistently exceeded the average wages paid by all U.S. manufacturing enterprises, as reported by the U.S. Bureau of Labor Statistics. For the year 1958 they were approximately 27 percent higher than the U.S. average for manufacturing employees. Mr. Reuther himself has publicly expressed his satisfaction with the agreements upon the signing of each labor contract.

It seems quite clear that if we are looking for the causes of the postwar increase in the price level, we must come back to the fact that the average hourly compensation in the private nonagricultural sector of the economy had increased in 1958 by about 66 percent above the 1947–49 average while output per employee-hour had increased about 24 percent. You will recognize that I am referring in part to the BLS publication on productivity, earnings, and prices with data for 1957 and 1958 added. It is inconceivable with wage increases of these magnitudes that prices would not be forced upward.

In contrast to Mr. Reuther's contention, the facts clearly indicate that General Motors' profits have not increased relative to dollar revenue and, in fact, 1958 net profit is actually below the average for the postwar period. In our testimony before the subcommittee of the Committee on the Judiciary we concluded with the following observation which, it seems to me, is appropriate here:

"The same economic forces are at work in our industry as in any other industry. The upward pressure of costs in the long run will affect prices, no matter what the industry.

"With rising costs, prices have to rise or else the automobile industry cannot long continue to supply the cars that the market wants. This is basic in a competitive industry and the automobile industry certainly is competitive."

I appreciate very much this opportunity to comment on Mr. Reuther's illustration and I hope that I have been able to contribute something which will be helpful to you, Representative Widnall, and the other members of the committee.

Sincerely,

F. S. DONNER.

[Attachment A]

*General Motors Corp. percentage breakdown of dollar revenue for the years 1926 through 1958*

| Year | Dollar revenue | Allocable to— | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | Suppliers [1] | Employees | Taxes | Depreciation | General Motors stockholders | | |
| | | | | | | Dividends | Reinvested | Total |
| 1926 | 100.00 | 55.98 | 21.84 | 3.12 | 1.88 | 10.29 | 6.89 | 17.18 |
| 1927 | 100.00 | 51.24 | 25.00 | 3.34 | 2.13 | 11.20 | 7.09 | 18.29 |
| 1928 | 100.00 | 51.31 | 25.38 | 2.82 | 2.08 | 11.63 | 6.78 | 18.41 |
| 1929 | 100.00 | 52.72 | 26.66 | 2.44 | 2.30 | 10.62 | 5.26 | 15.88 |
| 1930 | 100.00 | 51.93 | 27.39 | 2.54 | 3.68 | 13.40 | 1.06 | 14.46 |
| 1931 | 100.00 | 52.31 | 28.55 | 2.86 | 4.64 | 16.80 | (5.16) | 11.64 |
| 1932 | 100.00 | 58.11 | 31.38 | 2.15 | 8.32 | 14.02 | (13.98) | .04 |
| 1933 | 100.00 | 49.59 | 27.78 | 3.60 | 5.15 | 10.51 | 3.37 | 13.88 |
| 1934 | 100.00 | 52.93 | 29.73 | 2.73 | 3.85 | 8.36 | 2.40 | 10.76 |
| 1935 | 100.00 | 51.92 | 27.58 | 3.27 | 3.17 | 8.88 | 5.18 | 14.06 |
| 1936 | 100.00 | 50.90 | 26.23 | 4.12 | 2.72 | 13.58 | 2.45 | 16.03 |
| 1937 | 100.00 | 52.60 | 28.07 | 4.64 | 2.71 | 10.35 | 1.63 | 11.98 |
| 1938 | 100.00 | 54.76 | 26.74 | 4.82 | 4.31 | 6.74 | 2.63 | 9.37 |
| 1939 | 100.00 | 50.88 | 27.58 | 5.45 | 3.06 | 11.39 | 1.64 | 13.03 |
| 1940 | 100.00 | 50.95 | 26.99 | 8.92 | 2.50 | 9.30 | 1.34 | 10.64 |
| 1941 | 100.00 | 48.99 | 26.93 | 13.79 | 2.14 | 6.94 | 1.21 | 8.15 |
| 1942 | 100.00 | 46.35 | 37.38 | 6.53 | 2.59 | 4.20 | 2.95 | 7.15 |
| 1943 | 100.00 | 51.40 | 34.79 | 8.31 | 1.58 | 2.52 | 1.40 | 3.92 |
| 1944 | 100.00 | 54.07 | 32.60 | 7.84 | 1.49 | 3.30 | .70 | 4.00 |
| 1945 | 100.00 | 56.82 | 32.53 | 2.51 | 2.17 | 4.48 | 1.49 | 5.97 |
| 1946 | 100.00 | 48.82 | 44.28 | .16 | 2.29 | 5.54 | (1.09) | 4.45 |
| 1947 | 100.00 | 49.78 | 30.97 | 9.51 | 2.20 | 3.80 | 3.74 | 7.54 |
| 1948 | 100.00 | 50.23 | 28.50 | 9.83 | 2.10 | 4.47 | 4.87 | 9.34 |
| 1949 | 100.00 | 50.26 | 26.21 | 10.14 | 1.93 | 6.36 | 5.10 | 11.46 |
| 1950 | 100.00 | 46.83 | 25.74 | 14.79 | 1.61 | 7.13 | 3.90 | 11.03 |
| 1951 | 100.00 | 49.91 | 26.53 | 15.17 | 1.66 | 4.83 | 1.90 | 6.73 |
| 1952 | 100.00 | 48.35 | 27.99 | 14.52 | 1.81 | 4.75 | 2.58 | 7.33 |
| 1953 | 100.00 | 52.65 | 27.45 | 12.22 | 1.76 | 3.58 | 2.34 | 5.92 |
| 1954 | 100.00 | 51.10 | 27.97 | 10.44 | 2.35 | 4.54 | 3.60 | 8.14 |
| 1955 | 100.00 | 48.46 | 26.95 | 12.75 | 2.35 | 4.83 | 4.66 | 9.49 |
| 1956 | 100.00 | 49.59 | 28.91 | 10.55 | 3.18 | 5.19 | 2.58 | 7.77 |
| 1957 | 100.00 | 50.14 | 28.75 | 9.76 | 3.74 | 5.13 | 2.48 | 7.61 |
| 1958 | 100.00 | 51.20 | 29.93 | 7.91 | 4.37 | 5.95 | .64 | 6.59 |

[1] Payments for materials, services, etc.

NOTE.—Brackets indicate red figures.

The CHAIRMAN. This afternoon we will meet at 2 o'clock, not at 2:30, in this room, and various interested groups will appear.

Thereupon, at 12:30 p.m., the committee was recessed, to reconvene at 2 p.m., same day.)

AFTER RECESS

The CHAIRMAN. Gentlemen, we are very glad to have you here this afternoon. The other members of the committee will be in shortly, but I know your time is valuable, and perhaps we should begin now.

We would suggest that if possible you confine your discussion to about 7 minutes; then we will have general discussion afterward.

We will begin with the American Farm Bureau Federation, represented by Mr. Roger Fleming, secretary-treasurer.

We are glad to have you, Mr. Fleming.

## STATEMENT OF ROGER FLEMING, SECRETARY-TREASURER, AMERICAN FARM BUREAU FEDERATION

Mr. FLEMING. Thank you, Senator Douglas.

As an organization which is deeply conscious of the need for a better understanding of economic problems, the American Farm Bureau Federation welcomes this opportunity to comment on the "President's Economic Report" for 1959.

At the outset, I should like to call the committee's attention to the fact that a year ago we expressed some disappointment in what we thought was an overemphasis in the report on specific legislative recommendations, and so here in my prepared statement I have indicated we feel this report represents some improvement on that score.

For example, in our statement to this committee last year we commented as follows:

> The number and variety of these recommendations seeems to us to distract attention from the fundamental economic issues facing the Nation, and to suggest an unwarranted, and perhaps unintended reliance on legislation as a means of solving economic problems.
>
> For our part we would like to see more emphasis on analysis—more discussion of economic trends, the basic forces underlying these trends, emerging economic problems, and the alternatives facing the Nation—and less emphasis on legislative recommendations; particularly recommendations of the type that are relatively unimportant from an overall standpoint regardless of their individual merit.

We are pleased to note that this year's Economic Report appears to reflect some progress in the direction indicated by the remarks which I have just quoted.

In view of the limited time that is available we will confine our comments to a limited number of subjects which will serve to illustrate our general reaction to the Economic Report and related messages.

It is becoming increasingly clear that inflation is our most serious economic problem. The quick recovery of our economy from the recent recession demonstrates the basic strength of our private competitive enterprise system. The fact that we are again faced with the threat of inflation demonstrates the dangers of resorting to inflational policies every time there is a slackening of business activity.

Next in my prepared statement, Senator Douglas, I have sought to describe the new situation on the farms of America which has caused the historic attitude that was allegedly, at least, held by farmers with regard to inflation, to substantially change.

Historically, farmers have often favored inflationary policies but the thinking farmer of today knows that policies which destroy the value of the dollar are bad for agriculture.

This is readily understandable when we consider the changes that have been taking place in agriculture and in national tax policies. For many years farm land was the most important factor in agricultural production and farmers generally were a debtor class. Under such circumstances it was easy for many farmers to assume that inflation would benefit them by making it possible for them to pay off farm mortgages with cheap money.

I shall not develop the specifics of this analysis here in the verbal presentation, in the interests of time, but I do want to call that point to the chairman's attention.

The CHAIRMAN. Of course, historically speaking it is true that the fall in the price level from 1873 to 1896 meant that unless prices were subsequently increased the farmers would have been paying off their mortgages in dearer and not cheaper dollars.

Mr. FLEMING. Yes. And yet historically I think you would agree that there has been the assumption—and I saw it in print in a news magazine article this last week—that farmers were not at all worried about inflation, because it seemed to be in their interests. And I wanted to develop the point to indicate that we know better than that these days.

The CHAIRMAN. I have been trying to defend the position that the farmers during the period of the 1890's really were seeking "reflation" rather than inflation.

Mr. FLEMING. Yes.

Today, conditions are much different. Technology is decreasing the importance of land as a factor in agricultural production. The Department of Agriculture estimates that more than half of what economists refer to as "farm production inputs" now come from nonfarm sources. Purchased inputs generally consist either of goods which are quickly consumed or depreciable equipment. In either case farm production supplies must be paid for in a relatively short time and this reduces the possibility of paying off farm debts with cheap dollars.

Increased dependence upon "purchased inputs" makes farmers extremely vulnerable to rising prices in the rest of the economy. In the present situation where agriculture is troubled with surpluses and excess productive capacity it is clear that inflation would intensify the cost squeeze on farmers by causing farm costs to rise more rapidly than farm prices.

Taxes also contribute to the adverse effects of inflation on farmers under present conditions. Since farm equipment must be depreciated on a cost rather than on a replacement basis, farmers share with other businessmen the problem of holding their capital together in inflationary periods. Another adverse effect arises out of the fact that a farmer who sells his farm may find that he is required to pay a capital gains tax on an increase in dollar values that is really a reflection of currency depreciation rather than actual gain.

Over and above the fact that inflation would affect farmers more adversely today than any time in the past, farmers have a broad general interest as citizens in sound monetary policies. We believe that a more stable general price level is needed as a means of providing a favorable climate for economic growth and a rising standard of living. This is an essential condition for a prosperous agriculture. It is also essential if we are to avoid a far-reaching expansion of Government controls over individual decisions and actions, which inevitably would undermine individual freedom and limit individual opportunity. In this connection we are disturbed by the inference on page 6 of the "Economic Report" that inflation could be prevented by price and wage controls. Such controls are a fraud—they deal with symptoms rather than causes; instead of preventing inflation they conceal the fact of inflation until it is too late for corrective action.

Next we recommend, as we did a year ago, that the Employment Act of 1946 be amended to include as a goal a national policy to stabilize the purchasing power of the dollar as well as to maintain a high level of employment.

As a matter of fact, it is our opinion that the present language could be so interpreted, but we think it ought to be made even more explicit.

We agree with the President's recommendation for an amendment to the Employment Act of 1946. Farm Bureau policies for 1959 state that this act—

> should be amended to make it clear beyond any doubt that it is national policy to stabilize the purchasing power of the dollar, as well as to maintain a high level of employment.

In our opinion the present language of the Employment Act logically should be interpreted as implying such a policy; however, the national interest in a more stable price level is so great that the act should be amended to remove any possibility of misinterpretation on this point.

An unbalanced Federal budget is a major factor contributing to the present inflationary threat. We are concerned that Congress over the years has committed the Federal Government to a level of spending that is making it difficult to balance the budget even in a period of rising prosperity and high taxes.

The budget submitted by the President for fiscal 1960 indicates a very precarious balance between income and outgo. In order to insure that the budget will be balanced even if unforeseen contingencies should arise, the Congress has a responsibility not only to avoid embarking on nonessential new projects but to cut appropriations below the President's recommendations wherever this can be done by eliminating waste, duplication, or nonessential activities.

All economic and other interest groups should share in the sacrifices that are needed to balance the budget. We emphasize agriculture's readiness to share in the adjustments that must be made in Government programs to insure a budget that will be consistent with the objectives of checking inflation and achieving a sound economy.

Next we make clear our attitude with regard to the highway program, which is at variance with the recommendations of the President and calls for a stretchout rather than either increased gasoline taxes or going to the Federal Treasury for more money.

The President has recommended that the Federal gasoline tax be increased to avoid a deficit in the highway trust fund. Farm Bureau is opposed to any increase in the Federal gasoline tax or other Federal highway user excise taxes for roadbuilding and to the financing of the Federal share of the highway program from general tax funds. We favor an extension of the construction period for interstate highways so that Federal highway expenditures can be placed on a pay-as-we-go basis.

Then we indicate our attitude with regard to aids to housing and airport facilities and aid to depressed areas.

We recognize the need for improving airport facilities and can understand why city and local government officials want all taxpayers through participation of the Federal Goverment to share in the cost of such programs.

We think it is unjustifiable for the Federal Government to attempt to finance airport terminal buildings. There is usually much rivalry between cities and areas with regard to such terminal buildings. We can see no reason why the Federal Government should—and many reasons why it should not—get involved in underwriting essentially local matters of this kind. We believe that the responsibility of the Federal Government in this field should be limited primarily to expenditures for safety and for extension of runways where local governments will match Federal funds on a 50–50 basis.

Collections of appropriate user charges from airlines and others who use airport facilities would, in our opinion, further reduce the need for appropriated funds.

We believe that the recommendations of the Bureau of the Budget with regard to this subject will meet the most essential needs in this field and continue to give emphasis to State and local responsibility for financing these and similar improvements.

Large authorizations for expenditures for urban renewal and public housing would appear to be unnecessary on the part of the Federal Government and would be highly inflationary. Additional public housing expenditures at this time might actually be a deterrent to private construction which must be relied upon for the bulk of the housing construction. With the current threat of inflation, we would hope that the Congress would not authorize greatly increased expenditures in this field. We believe that the level of expenditures authorized in the Senate housing bill is excessive.

The Economic Report states that a program of assistance to depressed areas through development loans and grants for technical studies will shortly be recommended to the Congress. Farm Bureau is opposed to the enactment of Federal legislation to provide loan or grant assistance to depressed areas for a number of reasons including the following:

(1) Federal intervention in depressed area situations is not necessary.

(2) Federal intervention in determining the location of businesses and industries not in the long-run interest of the people of the United States.

(3) The assumption by the Federal Government of a responsibility for area redevelopment could defeat the objective of the proposed legislation.

We recognize that Government expenditures for agriculture are a large and growing part of the Federal budget. The present scale of these expenditures cannot be defended on the basis of the results that are being obtained. This situation can be changed only by the Congress, as present legislation provides little leeway for administrative changes in the fundamentals of national farm programs.

Any person informed in agricultural matters must agree with the President that the price-support and production-control program has not worked.

We are happy to see that the President has accepted the Farm Bureau proposal of tying support prices to a percentage of the average market price of the immediately preceding years. The old idea of misusing the parity formula as a price-fixing device has been employed far too long at a tremendous cost to all citizens, including farmers.

However, we cannot agree with the President that the Secretary of Agriculture, whoever he may be, should have the discretionary authority to determine what percentage of the market price history is to be used to establish price supports. Farm Bureau consistently has maintained—and does now—that putting wide discretionary authority in the hands of the Secretary of Agriculture to determine price support levels is unwise and could be dangerous.

Naturally Congress will want to take into account the differences among commodities if the market price support approach is to really serve its intended purpose.

The President has emphasized plainly the trap of direct payment and multiple price schemes. Direct payment plans would mean lower per family farm income and ultimate servitude of farmers to the Federal Government, more taxes and high-priced food to consumers. Multiple price schemes for wheat would bring subsidized competition to the producers of corn and other feed grains with eventual price depressing effects on all livestock, dairy, and poultry producers as well as unfair competition to our friends abroad.

The CHAIRMAN. Thank you very much.

The discussion will be continued by **Mr. Vincent A. Perry, representing** the Federal Statistics Users' Conference.

That is a new organization, so far as I am aware, and it is interesting, because for some time I regarded myself as the largest private consumer of Government statistics. I was quite interested to find actually a federation of consumers of statistics. Very interesting.

## STATEMENT OF VINCENT A. PERRY, TRUSTEE OF THE FEDERAL STATISTICS USERS' CONFERENCE

Mr. PERRY. Just as an aside, Senator Douglas, we have been in existence several years, and I just wonder where you draw the line where we are no longer characterized as being new.

The CHAIRMAN. It takes some time far me to catch up.

Mr. PERRY. Mr. Chairman and members of the committee, my name is Vincent A. Perry. I am manager of the Economic Analysis Division of General Foods Corp. I appear before you as a vice chairman of the Federal Statistics Users' Conference, and not as a representative of my employer.

Unlike most of the witnesses appearing before this committee, I am not addressing myself to the analysis contained in the President's "Economic Report." Rather, I would like to draw your attention to the analytical tools—Federal statistics—without which no "Economic Report" could be written.

The members of the Federal Statistics Users' Conference are business, farm, labor, and nonprofit research organizations which use Federal statistics and are interested in their improvement. They have joined together because they recognize that they have a common need for better data to help them make more informed current decisions and plans for the future.

It is rather disappointing to find no reference in the report to progress made in developing the integrated Federal statistics program. You will recall that last year's Economic Report devoted 21 pages to a discussion of various aspects of this program, including a rough outline for long-term improvements.

In contrast, this year's Economic Report notes the need for statistical improvements only in isolated paragraphs and does not focus attention on them as it did last year.

A short balance sheet showing the goals of the long-term program, progress made toward their achievement, and further steps proposed for the year ahead, would be a desirable feature in each year's report.

Special analysis I in the budget document only partly meets this need for a balance sheet. It falls short because it does not show the whole statistical picture. It does set out for the year ahead those improvements which will require additional money. But it fails to show improvements which do not call for more funds and it does not show advances stemming from the statistical activities of the Federal Reserve Board. Moreover, the budget document concentrates on the short term—the year past, the present year, and the year ahead—and fails to relate existing and proposed programs to long-term goals.

Except for the press release issued by this committee's Economic Statistics Subcommittee last autumn, little attenion has been given to improvements now being made in Federal statistics programs.

The results of one improvement—quarterly estimates of gross national product in constant dollars—are already available and can be seen in the "Economic Report." Results of another—monthly measures of retail accounts receivable—should be available soon.

Work is underway on other improvements which will provide better information on such widely scattered subjects as retail and wholesale inventories; manufacturers' sales and inventories; new private, nonresidential construction; hours worked and hours paid for in manufacturing industries; and U.S. investments abroad.

The Economic Report notes, but does not point up, further improvements in Federal statistical programs contained in the President's 1960 budget. If approved by Congress in their present form, the budget proposals would result in better and more timely foreign trade data; reliable information on expenditures for maintenance, repair and alterations of nonfarm residential property; improved consumer price index information; and estimates of labor requirements for specific kinds of construction activity. The budget also provides for further developmental work on the national economic accounts leading toward estimates of national product by industry in constant dollars and estimates of interindustry purchases and sales.

All of this represents progress toward the long-term goals outlined in last year's Economic Report. As users we welcome these steps along the long road to better statistics. We want to point out, however, that this year's rate of progress is slower than planned in the 1959 budget, since not all appropriation requests were granted. If you will examine the 1960 budget closely you will find that many of the proposed improvements which it contains were originally requested last year. These reiterated requests are, in effect, a measure of how far we fell short of the target this year. We may fall short again next year unless those who use statistical tools undertake the sustained effort that is required to explain the urgent need for better data.

The Federal Statistics Users' Conference exists because its members consider Federal statistics important in the conduct of their various activities. Since its formation in 1956 it has worked consistently for the development of a Federal statistics program of optimum usefulness at minimum cost. Its members are not interested in the mere proliferation of statistics; they are interested in better use of existing data and favor the collection of additional data only when it is apparent that existing materials are inadequate.

Some of the proposals being advanced once again are in the areas of national economic accounts and construction statistics. The Federal Statistics Users' Conference supported these proposals last year and continues to do so.

The improvements proposed in the national economic accounts are illustrative of the kind of improvements which can be obtained from a fuller use of existing data. Estimates of the national product by industry in constant dollars and of interindustry purchases and sales will supply information of great value to many different kinds of users without requiring the collection of additional information.

The proposed improvement in construction statistics will require the collection of data we do not now have. Present estimates of expenditures for maintenance, repair, additions, and alterations depend to a great extent upon the imaginative use of inadequate data by skilled analysts. The program proposed in the President's budget will provide these estimates with needed factual support. Reliable data are needed in this area because developments in this part of the $60 billion construction industry are obviously of importance both to businesses which are economically affected and to other users who are concerned with this area as a major segment of the national economy.

The Federal Statistics Users' Conference regards construction statistics as so important that it is holding a conference on Federal construction statistics here in Washington tomorrow. This meeting will bring together participants representing a broad spectrum of user interests. It will examine the whole area of Federal construction statistics to determine what the content of a comprehensive construction statistics program should be. It will describe the deficiencies in existing data as seen by users and will define the relative importance of existing gaps in information. Finally, it will examine and evaluate the 1960 construction statistics program in terms of the priority needs for information felt by users. Representatives of statistics-producing agencies will attend the conference's opening session, and their presence should lead to a fruitful exchange of views. Copies of any reports issuing from this conference will be furnished to this committee.

In closing, I would like to express the appreciation of the Federal Statistics Users' Conference for this opportunity to appear here today. This committee has an even longer record of consistent effort aimed at getting better Federal statistics than has the Federal Statistics Users' Conference. We hope that your efforts in this direction will continue. Better economic intelligence is important to us both. As an arm of the Congress of the United States, you know how important these data are to you. As nongovernmental users, we know that they are vital to us.

The CHAIRMAN. Thank you very much.

(The following data was submitted by the witness:)

ROSTER OF MEMBERS, FEDERAL STATISTICS USERS' CONFERENCE

ASSOCIATIONS

American Association of Advertising Agencies
American Gas Association
Chemical Market Research Association
Insulation Board Institute
Mortgage Bankers Association of America
National Association of Broadcasters
National Association of Home Builders
National Association of Mutual Savings Banks
National Automobile Dealers Association
National Sales Executives, Inc.
Plumbing Fixtures Manufacturers Association
U.S. Savings & Loan League

BUSINESS SERVICES

Alderson Associates
Arthur Andersen & Co.
McKinsey & Co., Inc.
Market Research Corp. of America
Newmyer Associates
A. C. Nielsen Co.
Alfred Politz Research
R. L. Polk & Co.
Elmo Roper & Associates
Standard Rate & Data Service, Inc.
Survey & Research Corp.
A. J. Wood & Co.
Young & Rubicam

FARM ORGANIZATIONS

Cooperative GLF Exchange, Inc.
Missouri Farmers Association
National Farmers Union

FINANCE AND TRADE

Bank of America
Bankers Trust Co.
The California Bank
Chase Manhattan Bank
Commercial Investment Trust, Inc.
Czarnikow-Rionda Co.
DeVegh & Co.
Lionel D. Edie & Co., Inc.
First National City Bank of New York
Irving Trust Co.
John Hancock Mutual Life Insurance Co.
Loomis, Sayles & Co., Inc.
Massachusetts Investors Trust Co.
Mellon National Bank & Trust Co.
National Bank of Detroit
National Securities & Research Corp.
New York Stock Exchange
Prudential Insurance Co. of America
Sears, Roebuck & Co.

MANUFACTURING

American Can Co.
American Radiator & Standard Sanitary Corp.
American Viscose Corp.
Armour & Co.
Bristol-Myers Co.
Burroughs Corp.
Carrier Corp.
Caterpillar Tractor Co.
Celanese Corp. of America
Colgate-Palmolive Co.
Continental Can Co.
Continental Oil Co.
Corn Products Refining Co.
Crown Zellerbach Corp.
Deere & Co.
Dresser Industries
Firestone Tire & Rubber Co.
Ford Motor Co.
General Foods Corp.
General Mills, Inc.
The Gillette Co.
Gulf Oil Corp.
H. J. Heinz Co.
International Business Machines Corp.
International General Electric Co.
International Harvester Co.
Johns-Manville Corp.
The Kendall Co.
Kimberly-Clark Corp.
Eli Lilly & Co.
McKesson & Robbins, Inc.
Mead Johnson & Co.
Merck, Sharp & Dohme
Minnesota Mining & Manufacturing Co.
National Blank Book Co.
National Cash Register Co.
Pillsbury Mills, Inc.
Pittsburgh Plate Glass Co.
Procter & Gamble Co.
Ray-O-Vac Co.
Remington Rand
St. Regis Paper Co.
Scott Paper Co.
The Simmons Co.
The Singer Manufacturing Co.
Standard Oil Co. (California)
Standard Oil Co. (Indiana)
Standard Oil Co. (New Jersey)
Stanley Home Products, Inc.
Stromberg-Carlson Co.
Union Bag-Camp Paper Corp.
Union Carbide Corp.
The Upjohn Co.

LABOR UNIONS

Amalgamated Clothing Workers of America, AFL–CIO
Brotherhood of Railroad Trainmen
Communications Workers of America
Industrial Union of Maritime & Shipbuilding Workers of America

ROSTER OF MEMBERS, FEDERAL STATISTICS USERS' CONFERENCE—Continued

LABOR UNIONS—continued

Industrial Union Department, AFL–CIO
International Association of Machinists
International Brotherhood of Electrical Workers
International Brotherhood of Teamsters
International Ladies' Garment Workers' Union
International Union of Brewery, Flour, Cereal, Soft Drink & Distillery Workers of America
International Union of Electrical, Radio & Machine Workers
Retail Clerks International Association
Textile Workers Union of America
United Association of Journeymen & Apprentices of the Plumbing & Pipe-Fitting Industry
United Auto Workers
United Rubber, Cork, Linoleum & Plastic Workers of America
United Steelworkers of America
United Textile Workers of America

NONPROFIT RESEARCH ORGANIZATIONS

Advertising Research Foundation
American Marketing Association
Brookings Institution
Committee for Economic Development
National Association of Housing & Redevelopment Officials
National Planning Association
Twentieth Century Fund

PUBLIC UTILITIES AND TRANSPORTATION

Consumer Power Co.
New York State Natural Gas Corp.
The Pennsylvania Railroad Co.

PUBLISHING

Advertising Publications, Inc.
Architectural Forum
Associated Business Publications
Curtis Publishing Co.
Farm Journal, Inc.
Look Magazine
McGraw-Hill Publishing Co.
Meredith Publishing Co.
Sales Management, Inc.
Time, Inc.
U.S. News Publishing Co.

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Vice chairmen:
 Vincent A. Perry, General Foods Corp.
 John A. Baker, National Farmers Union
 Peter Henle, AFL–CIO
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Executive secretary: Roye L. Lowry

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 Vincent A. Perry, General Foods Corp.
 Stuart A. Rice, Surveys & Research Corp.
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 Robert B. Child, Cooperative GLF Exchange, Inc.
Labor group:
 Solomon Barkin, Textile Workers Union of America
 Charles Donahue, United Association of Plumbers & Pipe-Fitters
 Peter Henle, AFL–CIO
 Lazare Teper, International Ladies Garment Workers Union
 Nat Weinberg, United Auto Workers
Nonprofit group:
 Gerhard Colm, National Planning Association
 Ingrid Kildegaard, Advertising Research Foundation
 Herbert Stein, Committee for Economic Development
 Howard L. Stier, American Marketing Association
 Ralph J. Watkins, Brookings Institution

(The following was subsequently submitted for the record:)

REPORT ON CONGRESSIONAL ACTION ON APPROPRIATIONS FOR FEDERAL STATISTICAL PROGRAMS

Congressman Richard Bolling (Democrat, Missouri), chairman of the Subcommittee on Economic Statistics of the Joint Economic Committee, released today the attached statement on appropriations for fiscal 1959 for the Federal Government's statistical program. This statement, which was prepared by the Office of Statistical Standards of the Bureau of the Budget, is based on "Special Analysis I" of the 1959 budget document. "Analysis I," which was developed at the request of the Subcommittee on Economic Statistics for inclusion in the President's annual budget, presents in summary fashion the budgets for Federal economic statistical programs.

In commenting on the comparison of final congressional action with the recommended program as set forth in the President's budget, Congressman Bolling said:

"In view of the need for additional statistical information for making sound and timely economic decisions which has been revealed by the investigations of the Subcommittee on Economic Statistics, it is indeed gratifying that Congress has made available for statistical programs an increase of $757,000 over the sum available in fiscal 1958. About $650,000 of the increase for fiscal 1959 in appropriations for statistical programs was made for items recommended in the budget to provide for an integrated program of improvements in current economic statistics. Even though the increase allowed falls short of the $1.5 million increase requested, it still will make possible significant progress on the integrated program as the attached review of the various programs indicates.

"It is particularly gratifying that funds will be available for the preparation of quarterly estimates of GNP in constant dollars and for a limited amount of other work associated with the national economic accounts. Increases in funds also will enable progress to be made in several other programs where the subcommittee has found a pressing need for improvements in both the quality and scope of data.

"This year's action on funds for the Federal statistical programs is encouraging evidence of the development of an adequate and integrated Federal statistical program. Both private and public users of economic data will, I am sure, join with the subcommittee in expressing the hope that in the forthcoming year it will be possible to make even further progress."

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
*Washington, D.C., September 5, 1958.*

Hon. RICHARD BOLLING,
*Chairman, Subcommittee on Economic Statistics, Joint Economic Committee, U.S. Congress, Washington, D.C.*

MY DEAR MR. BOLLING: In response to your request of August 22, I am enclosing a summary analysis of the statistical programs contained in the 1959 budget document, in "Special Analysis I." The analysis shows the amounts available in 1958, the request for 1959, and the amount available in 1959, with special reference to the improvements in current economic statistics in which the Joint Economic Committee has been interested.

Sincerely yours,

RAYMOND T. BOWMAN,
*Assistant Director for Statistical Standards.*

## 1959 APPROPRIATIONS FOR PRINCIPAL STATISTICAL PROGRAMS

### I. CURRENT PROGRAM

The budget estimates for 1959 included about $34,750,000 for the principal current statistical programs of the Federal Government, as described in "Special Analysis I" of the 1959 budget document. Final action on these appropriation requests allowed $33,633,000—an increase of $757,000 over 1958 but a reduction of $1,115,000 from the budget estimates.

The amounts available for 1958, the requests for 1959, and the amounts available for 1959 are shown by agency and by broad subject areas in the accompanying tables. Both tables show totals for 1958 and 1959 with and without adjustment for the pay increase enacted in June, retroactive to January 1, 1958. For purposes of comparability, the separate program and agency figures are shown without adjustment to the new salary base.

The Subcommittee on Economic Statistics of the Joint Economic Committee has been particularly interested in the proposals included in the 1959 budget recommendations for an integrated program of improvements in current economic statistics. The increases recommended for these projects totaled about $1.5 million. Final action on the 1959 appropriations reduced this amount to about $650,000.

The proposals comprising this integrated program were included in the 1959 budget estimates of the Bureau of the Census and the Office of Business Economics in the Department of Commerce and the Bureau of Labor Statistics in the Department of Labor. A brief summary of the proposals, indicating the amounts requested and the amounts which will be available in 1959, is given below. The figures refer to the estimated costs of the specific proposals, and do not take into account various adjustments reflecting savings and minor shifts within allocations.

*Bureau of the Census*

Increases totaling $975,000 for projects included in the overall program for improving economic statistics were the major part of the Census Bureau's requested increase of $1,038,200. The increase allowed for the Bureau was reduced to $168,200. This increase supplemented by $235,800 anticipated as a result of nonrecurring costs, introduction of efficiencies, and other reductions in costs from 1958 will permit a start to be made on a number of the projects proposed for 1959.

In the area of production and distribution statistics, increases totaling $375,000 were requested: $100,000 to expand existing retail and wholesale inventory surveys and provide estimates of inventories for key commodities; $100,000 to initiate a monthly survey to provide reliable estimates of service trade receipts; $100,000 to obtain a monthly measure of accounts receivable (consumer credit) for retail trade; and $75,000 to improve the monthly industry survey of manufacturers' sales, inventories and new orders. As a result of the reduction in the budget estimate, less than 60 percent of the amount requested for these projects will be available in 1959. With the funds which are available, improvements are being initiated in the monthly industry survey of manufacturers with the objectives of increasing its accuracy, achieving prompter release of the data, and providing more detailed figures classifying sales and inventories by major product classes. Work will also be started, although on a more limited basis than planned, on the projects for developing retail and wholesale trade inventory estimates for some key commodities and for developing monthly measures of retail accounts receivable. No work is planned this year on collection of data on service trade receipts.

In the area of construction statistics, an increase of $500,000 was requested to make a quarterly survey of expenditures on additions, alterations, maintenance, and repairs of residential properties and to develop a survey of such expenditures for nonresidential properties; and to conduct surveys to improve the reliability of the monthly estimates of total construction activity. Only about one-fourth of the increase requested will be available. A start will be made on a data collection program to improve estimates of new private nonresidential construction.

In the area of improving statistics for the national accounts, an increase of $100,000 was requested to initiate sample surveys to provide quarterly estimates of State and local government revenue, expenditure, indebtedness, and financial assets. No funds will be available for this project in 1959.

*Office of Business Economics*

The increase of $282,000 in the 1959 budget estimate for the Office of Business Economics was reduced by congressional action to $115,000. The proposed increase was designed to provide for the following projects: $202,000 for several specific projects to extend and improve the national income accounts; $20,000 to restore the quarterly reports on business births and deaths; $50,000 to prepare a survey of U.S. private investments in foreign countries (for the first of a 2-year program); and $10,000 for publication of the 1959 Business Statistics Supplement to the Survey of Current Business.

For the improvements proposed in the national income field, the increase allowed for 1959 will permit the Office of Business Economics to complete the preparation of quarterly estimates of gross national product in constant dollars, and to initiate a limited amount of work on the preparation of net output measures and on the estimation of purchases and sales, by industry. It will not be possible in 1959 to establish a separate research staff, as recommended by the National Accounts Review Committee, to work on basic conceptual and structural problems in the national accounts.

With the increase allowed for 1959, the Office of Business Economics has also initiated work on the survey of foreign investments—the first since 1950—and will publish the 1959 edition of "Business Statistics."

*Bureau of Labor Statistics*

Of the $372,000 increase in the 1959 budget estimate for the Bureau of Labor Statistics, $285,000 was requested for projects which were part of the integrated program for improving economic statistics; $100,000 for specific improvements in the area of wholesale and retail price statistics, including improvements in the quality of price data (particularly wholesale prices for industrial equipment, machine tools and other capital goods) and development of improved price deflators; $100,000 for 3 additional projects on statistics of employment and hours of work; and $85,000 for expansion of productivity estimates to additional industries and industry sectors. Congressional action allowed the Bureau of Labor Statistics a total increase of $224,500 out of the $372,000 requested for 1959.

In the area of price statistics, the additional $100,000 requested will be available in 1959 but part of the increase will be used for projects recommended by the Congress which had not been included in the 1959 budget estimate. The list of commodities priced for the "Wholesale Price Index" will be expanded, with emphasis on series related to capital equipment, and a quality control program will be initiated to provide a more adequate review and evaluation of prices currently collected at the primary market level. Attention will also be given to improvement of prices collected for the "Consumer Price Index," especially for the medical care component. Work will continue on the city worker's family budget and on a budget for elderly couples.

In the area of labor statistics, about one-half of the $185,000 increase requested for additional detail in employment and hours series and for extension of productivity estimates to additional industries will be available in 1959. An annual survey will be initiated to determine the relationship between "hours paid for" and "hours worked" in manufacturing industries. Collection of information on nonproduction workers in manufacturing industries will either be postponed or undertaken on a very limited basis, and extension of the employment series to important nonmanufacturing industries will not be possible in 1959. Some new studies of trend and technological factors will be undertaken in the productivity program, but will probably be limited to two-digit industries.

## II. PERIODIC CENSUS PROGRAM

For the periodic census programs, all of which are conducted by the Bureau of the Census, final action allowed $14,350,000 of the $14,695,000 requested, as shown in the following tabulation:

[In thousands. Figures exclude pay increase adjustments]

| | 1958 appropriation | 1959 budget estimate | 1959 appropriation |
|---|---|---|---|
| "1958 Censuses of Business, Manufactures, and Mineral Industries" | $1,000 | $7,300 | $7,000 |
| "1960 Censuses of Population and Housing" and "1959 Census of Agriculture" | 3,250 | 7,000 | 7,000 |
| "1957 Census of Governments" | | 395 | 350 |
| Total, periodic censuses | 4,250 | 14,695 | 14,350 |

*1957 Census of Business, Manufactures, and Mineral Industries*

Collection of information for the 1958 economic censuses will begin early in calendar year 1959. The $7 million appropriation for fiscal year 1959 will provide for the printing, mailing, and collection of most of the report forms and these censuses, and for some of the editing which will be started as the schedules are returned. Funds for completion of editing and for tabulation and printing of the reports will be requested for fiscal years 1960 and 1961.

*1960 Censuses of Population and Housing and 1959 Census of Agriculture*

Intensive preparatory work for the 18th decennial census, which includes the censuses of population, housing, and agriculture, was started in fiscal year 1958 and will continue in 1959. An objective in these censuses is to achieve faster release of tabulated results through extension of sampling and by use of electronic equipment for processing and tabulating the returns. The $7 million appropriated for fiscal year 1959 provides for final determination of the questions to be asked and procedures to be employed, preparation of enumeration maps, printing of questionnaires and related forms, and field testing of procedures and schedules. It also includes about $2.1 million for completion of the purchase of the major components of electronic equipment needed for rapid and economical processing of census results. The cost of these censuses, including preparatory work, will spread over 6 fiscal years.

*1957 Census of Governments*

The total cost of the 1957 Census of Governments was originally estimated at $2.1 million. An apropriation of $1,750,000 was made in fiscal year 1957, of which about $1,650,000 was obligated in fiscal years 1957 and 1958. For fiscal year 1959 a final appropriation of $395,000 was recommended—the balance of $350,000 for the total estimated cost of the census plus $45,000 required by legislation enacted since the time of the original estimate, such as direct agency contributions to the civil service retirement fund. The appropriation of $350,000 made will be used to complete processing phases and to tabulate and publish the final results.

TABLE 1.—*Appropriations or allocations for principal current statistical programs, by broad subject areas*

[In thousands]

| | 1958 appropriation | 1959 budget estimate | 1959 appropriation |
|---|---|---|---|
| Labor statistics | $7,237 | $7,421 | $7,277 |
| Demographic statistics | 4,396 | 4,540 | 4,540 |
| Prices and price indexes | 3,218 | 3,324 | 3,321 |
| Production and distribution statistics | 12,653 | 13,219 | [1] 12,924 |
| Construction and housing statistics | 753 | 1,233 | 858 |
| National income and business financial accounts | 4,619 | 5,010 | 4,743 |
| Total, excluding pay increase adjustment | 32,876 | 34,748 | 33,663 |
| Estimated pay increase adjustment | 1,173 | 2,896 | 2,896 |
| Total, including pay increase adjustment | 34,049 | 37,644 | 36,559 |

[1] Includes $100,000 not included in budget estimate.

NOTE.—Detail will not necessarily add to totals because of rounding.

TABLE 2.—*Appropriations or allocations for principal current statistical programs, by agency*

[In thousands]

| Agency | 1958 appropriation | 1959 budget estimate | 1959 appropriation |
|---|---|---|---|
| Department of Agriculture: | | | |
| Agricultural Marketing Service: | | | |
| Economic and statistical analysis | $1,536 | $1,535 | $1,535 |
| Crop and livestock estimates | 5,576 | 5,576 | [1] 5,676 |
| Agricultural Research Service: Farm economics research | 2,709 | 2,709 | 2,709 |
| Department of Commerce: | | | |
| Bureau of the Census | 7,882 | 8,920 | 8,050 |
| Business and Defense Services Administration: Construction statistics | 142 | 160 | 160 |
| Office of Business Economics | 1,035 | 1,317 | 1,150 |
| Department of Health, Education, and Welfare: | | | |
| Office of Education: Research and statistical services | 583 | 597 | 597 |
| Public Health Service: | | | |
| National Office of Vital Statistics | 1,513 | 1,513 | 1,513 |
| Public health methods and reports | 1,800 | 1,936 | 1,936 |
| Department of Labor: Bureau of Labor Statistics | 7,200 | 7,572 | 7,424 |
| Treasury Department: Internal Revenue Service: Statistical reporting | 2,500 | 2,500 | 2,500 |
| Federal Trade Commission: Financial reports | 210 | 210 | 210 |
| Securities and Exchange Commission: Section of Economic Research | 190 | 202 | 202 |
| Total, excluding pay increase adjustment | 32,876 | 34,748 | 33,663 |
| Estimated pay increase adjustment | 1,173 | 2,896 | 2,896 |
| Total, including pay increase adjustment | 34,049 | 37,644 | 36,559 |

[1] Includes $100,000 not included in 1959 budget estimate.

NOTE.—Detail will not necessarily add to totals because of rounding.

The CHAIRMAN. The discussion will be continued by Mr. Ralph Bradley, State president of the Illinois Farmers Union, representing the National Farmers Union, both a constituent and a friend of mine.

Glad to have you with us.

## STATEMENT OF RALPH BRADLEY, STATE PRESIDENT OF THE ILLINOIS FARMERS UNION, REPRESENTING THE NATIONAL FARMERS UNION

Mr. BRADLEY. Thank you, Senator Douglas.

As the chairman has said, I am standing in for John Baker, legislative representative of the Farmers Union, and I have a prepared statement which I would like to read.

The President's 1959 Economic Report is a distinct disappointment, if measured against our national needs and challenges.

It does not provide leadership or challenge to the American economy to do what it must and can do in the year ahead.

The President's Economic Report proposes no way, except relative stagnation, to stop administered price inflation.

The Economic Report recommends measures that will further reduce, not improve, farm family income and that will increase, not reduce farm family cost of production and cost of living.

The 1959 Economic Report sets no goals or quotas for employment, income, consumption, or production, as appear to be clearly required by the Employment Act.

The report sets no forward-looking goals or guides for farm family income; none for the production, consumption, and exports of farm commodities.

The report contains no recommendations of means to eliminate rural, or urban, poverty. No mention is made of needed programs to insure that temporary unemployment or low income shall not be a bar to adequate nutrition in this Nation of abundant food production.

The report appears, implicitly, to be complacent about an annual economic growth of no more than the population increase. Whereas it is our conviction, that the Nation should follow policies that will bring about an annual real economic growth of at least 5 percent of the previous year's gross national product.

Measures to reduce chronic unemployment and underemployment are mainly honored by their omission from the report.

The report is quite inadequate in its recommendations concerning housing, health services, social security, public assistance, and Federal aid to school construction, to proper teachers' salaries, and to scholarship loans and grants.

While we are not experts in the field of national and free world defense expenditures, all fear that the emphasis in the report, on budget balancing, and "other slowdown techniques" as a way of combating administered price inflation has probably resulted in timid shortsighted goals as to how much the Nation should and can do in defense and foreign economic aid.

We welcome the recognition that the food produced by our farms can and should be used as a vibrant instrument for peace and free world economic growth. We regret, however, that the report places emphasis in this regard on disposal of past accumulations in Government ownership of so-called surpluses rather than upon imaginative use of abundant production in future years of which American farms and farm families are efficiently capable of providing.

We are refreshingly surprised with the official evidence placed in the report of the acknowledged failure of the Farm Bureau flexible farm policies carried out over the past 6 years by the administration.

We are alarmed and saddened, however, that the only recommendations the President makes to correct the failure of his farm policy is to recommend even more of the same.

As members of the committee know, the flexible farm policy has been designed to and did lower support levels for farm commodities from year to year. This was claimed to be needed to correct and eliminate the bad effects of so-called high rigid price supports.

The flexible farm policy has failed its stated purpose to reduce retail prices of food to consumers. Instead the index of retail food prices is up about 7 percent.

The administration's freedom farm policy has failed its stated purpose to raise farm family income. Instead, farm net income is down by nearly one-fourth.

The administration's farm policy of lower and lower supports has failed its stated purpose to reduce Government costs of the farm program. Instead, budget expenditures of the Department of Agriculture are not only at a record high but are more than five times as high as before inauguration of the flexible farm policy.

The administration's flexible farm policy has, also, very severely failed its stated objective to reduce the volume of farm commodities in Government ownership. As the President himself points out, Government stocks will be at an alltime record high in July 1960, almost 10 times as great as on inauguration day of 1953.

We urge Congress to reject the President's recommendations to increase REA interest rates, to impose additional unfair taxation on farmer cooperatives, and to reduce appropriations for conservation and farm ownership, housing and electrification loans.

The cause of family farmers all over the land will be severely weakened if Congress should, as we do not believe it will, accept the President's recommended abandonment of the parity concept. To urge adoption of price-support levels at from 10 to 25 percent below market prices as the President has done is tantamount to recommending that the programs be abolished completely.

We urge the Congress, instead of accepting the President's economic recommendations, to make its own studies and to move toward adoption of the measures that will underwrite a policy of growth, strength, and expansion.

Congress should move with all deliberate speed to enact, over a veto, if that becomes necessary, a comprehensive farm income improvement measure to replace the existing downward sliding farm income policy.

In 1957, the light major retail food chainstores averaged over 14 percent return, after taxes, on stockholders' equity for investment risk and entrepreneurship, after paying fairly adequate wages and high management salaries.

Is it asking too much that farmers be able to do the same, before taxes? Or should we abandon, as the report recommends, the time-honored idea of farm parity that farmers should be enabled to earn and receive a fair share of the national income?

We shall work with the Congress through the coming months to develop and enact a Federal farm program that will enable family farmers to earn and receive a return on their labor, farm investment, risk, and management equavilent to the returns earned on similar productive resources in other segments of the economy.

That concludes our presentation.

The CHAIRMAN. Thank you very much.

The discussion will be continued by Roy Battles, assistant to the master of the National Grange.

## STATEMENT OF ROY BATTLES, ASSISTANT TO THE MASTER, THE NATIONAL GRANGE

Mr. BATTLES. My name is Roy Battles, and I am assistant to the master of the National Grange.

The Grange appreciates the courtesy extended by this committee and its chairman—the courtesy of being permitted to participate in this panel and to offer comments concerning the "President's Economic Report."

It is entirely appropriate—in fact, commendable, we think—that the President should have devoted a material portion of his 1959 Economic Report, as he did, to an analysis of the current recession and the programs used to attempt to end that recession.

The President reviewed in detail his appraisal of the economic factors that led up to the recession, what happened during the recession, how the tools provided by Congress over the years were used in an effort to end it, and the results obtained.

While this appraisal is mostly a matter of opinion, it is, nevertheless, highly valuable.

At a Nation, we must learn all we can about how to achieve economic stability—stability against marked degrees of deflation as well as inflation. The President's report will help us with that understanding.

A maximum degree of understanding is necessary due to the fact that the consequences of either material inflation or anything like a major depression in our time—in a time when our national society and economic climate is extremely complex; when people in groups are almost fully interrelated and specialized—one dependent upon the other—would pose problems of a major magnitude.

At this stage of our national history, furthermore, we of the Grange are much encouraged by the fact that both the Congress and the executive branch of Government—along with the private sector of our economy—have prevented the post-World War II recessions from degenerating into depressions. We could argue a long time about what might have been in terms of potential gross national product, et cetera, but the fact remains that since VJ-day we have had three recessions—the recessions of 1948 and 1949, the 1953 setback, and, of course, the one from which we are just now recovering. Unlike the depression beginning in 1929—which, by the way, began much earlier in agriculture—these three periods of declining economic activity have not precipitated a major depression.

Whether or not we collectively have the brains, the mechanisms, and the capacity to prevent future periods of adjustment from getting out of hand, we do not know. But one thing is sure; we must learn all we can as we go along in order that we may handle this matter of economic stability and growth with a maximum of intelligence.

It is evident, meanwhile, that we either do not know how to control inflation or we aren't willing or able to effectively do the job. Since World War II, for instance, using the 1947–49 period as 100, the wholesale price index now stands at 119. Based on this period, however, the wholesale food price index in 1958 averaged only 95. This means that if wholesale food prices had moved upward instead of downward in the same relationship with other products, the general price index would not now stand at 119 but at 126. It is apparent that wholesale prices have on the average advanced 20 percent in the last 10 or 12 years, and that they would have moved upward 25 percent if food had not lost so much price ground during that period. This is a sizable amount of devaluation in what a dollar will buy. It has cut materially the level of living, the worth of nonproperty savings, and the potential buying power of huge blocks of Americans.

Last year before this committee we heard industry and labor blame each other for the wage-price spiral, and this buckpassing continues. As rural people, as heavy users of the products of business and labor, as a segment of the economy that is unable to pass on to consumers the added costs of ever-rising prices of production and marketing supplies and services, this is rapidly becoming a monotonous story.

It is clearly apparent also that Government—both the Congress and the executive branch—has a vital part to play in a stable economy with a dollar that maintains its value over the years.

And a balanced budget is unquestionably an important factor in maintaining that stability.

We of the Grange do not intend to get into the current controversy as it relates to a balanced Federal budget since we simply do not know at what level defense expenditures should be maintained at this time.

One thing is sure, however, and that is that in normal times—in fact, if at all possible at all times—it makes good sense to lower taxes and/or increase governmental expenditures during periods of recession or worse and maintain existing tax levels—cut Federal expenditures and pay off debt during periods of prosperity such as the one we now seem to be heading into.

Turning now to those sections of the President's Economic Report that have to do with agriculture, farmers know full well that a vigorous state of health in the total American economy is a definite prerequisite for the economic health of the Nation's agriculture. We also know full well that unhealthy economic conditions on the land represent a dead rocklike weight on the total that is America, thus preventing the Nation from reaching anything like its total potential in terms of economic activity.

The President analyzes well the farm situation and the necessity for a new approach to the solution of the problem. We agree that the cost of price stabilization programs must be drastically lowered. We agree that the Government must be largely eliminated from the American scene as a market place for surplus farm commodities.

We do not agree with the implications in the President's report that—

1. Price-support programs for basic crops have caused most of the surplus production;
2. The 2.2 million so-called commercial farmers are doing well financially on the average; and
3. All we have to do to solve the problem is to lower the level of price support.

In short, the President's analysis of the farm problem is objective and reasonably accurate and realistic—with the above exceptions—but is greatly disappointing in that it offers no real solution to the problem— either now or over the next several years.

It is our opinion that by merely lowering the level of price supports, as the President suggests in his special farm message, will not now nor in the immediate future sufficiently increase consumption or decrease production to solve the problem, not that lower prices for some commodities are not desirable. The problem is that the President offers no means of preventing these lower prices from bankrupting many farmers and putting thousands of others several notches lower on the economic level of living totem pole.

It is the position of the Grange that we need commodity programs, with the help of Federal enabling legislation where necessary, that will place in the hands of farmers some reasonable degree of effective control over their own marketing.

We need programs which place the responsibility for surpluses in the hands of producers themselves. We need programs that will enable price to perform its function and at the same time protect farm income. We need programs that will enable farmers to cope with ever-rising production and marketing costs. We need programs that secure income for farmers from consumers—not from taxpayers. We need programs that will enable farmers to continue to produce and market better products more efficiently. We need programs that are tailored to serve the peculiar needs of individual commodities. We need programs that prevent a small surplus from setting the price of the total output.

In short, farmers want and need the same sort of economic power enjoyed by organized labor and most industries. They need and want bargaining position that they do not now have. They want and need producer-managed marketing machinery.

Sometimes these powers can be achieved voluntarily, but more often farmers will need the power of Government to provide the framework in which to acquire them.

No one has all of these programs ready and perfected, but we have some of them well developed. Had we started perfecting these mechanisms a few years ago, we would not now face this crucial problem. It is deplorable that we have lost so much time in a useless, fruitless, academic argument.

We need national experience. There is no quick or easy way out of this present agricultural dilemma. We feel that the right road is the self-help, self-financing road, and we feel that farmers are ready to take this road, provided we can get the machinery to do the job.

I would remind you that the sugar program is working well; that the lamb and wool program is also working well, and that the marketing agreement approach for several of the specialized crops has worked well for many years.

We have a dairy self-help stabilization program well developed. The same is true of a program developed by the turkey growers. The domestic parity, or certificate approach for wheat and rice is a similar approach and is well developed. Others are in the making.

I should like to conclude by saying that it is our hope that the 86th Congress will assume the general philosophy that farmers need mechanisms to enable them to help themselves, and that the self-help approach is the best and wisest approach to one of the Nation's most knotty problems—namely, the farm problem.

Thank you very much.

The CHAIRMAN. Do you publish the details of these new programs, such as the dairy self-help, and for turkey growers, wheat, and rice?

Mr. BATTLES. Yes, Senator. They have been introduced here as bills in each case—the dairy program last year and again this year, and the turkey program. And, of course, the domestic parity plan for wheat was passed by both Houses of the Congress and vetoed by the President 2 years ago.

The CHAIRMAN. I understand that fundamentally you propose for wheat and rice a two-price system with a lower price abroad than at home.

Mr. BATTLES. It is really, Mr. Senator, a one-price system, allowing price to perform its function and then building income to farmers on their share of the domestic consumption for food of wheat for each farmer by way of a cashable or negotiable certificate which would be paid for the processors of wheat and in turn passed on to the consumer. This certificate would be the means of raising income to wheatgrowers over and above the price that they received in the marketplace on their share of the domestic consumption for food.

The CHAIRMAN. Thank you.

I am very happy to welcome you, Mr. Rettig, representing the National Independent Union Council.

## STATEMENT OF ROGER M. RETTIG, PRESIDENT, NATIONAL INDEPENDENT UNION COUNCIL

Mr. RETTIG. Mr. Chairman, at this hearing I will present the position of the National Independent Union Council as president. I am also president of the Electrical Workers Independent Union in St. Louis, Mo. We maintain our national council headquarters here in Washington.

When appearing before this committee on the Economic Report, we wish to stress the importance of the independent labor movement. Of the more than 65 million gainfully employed people in this country, more than 50 million are presently represented by independent unions or as yet unorganized. Most of the unions we represent, and for whom I speak today, are unions where the officials are elected directly by the employees in a particular shop, factory, craft, or industry where they work. Most of the representatives of these unions, including myself, are men and women who have worked on the job themselves and who are still in direct contact with the members.

In our relationship to the economic situation in this country, and to the organized labor movement, our position could be compared with the thousands of small businessmen in this country and their position as compared with the representatives of the giant corporations.

We note with interest that the President has given his analysis of the 1957–58 economic situation, including the recession which was so evident and painful for the members of our unions, who work for a living or were laid off, when we appeared before this committee last year. Now that there are signs of improvement we believe it is time to analyze the reasons and to give credit where credit is due. Also to take necessary measures to bring about an improvement in this situation in preparation for the next unfavorable cycle.

The first significant factor of stabilization, that prevented the recent recession from becoming more acute, was undoubtedly the fact that union contracts in effect provided insurance of rates of pay, reasonable hours, and the consequent elimination of panic which always results when companies start slashing hours and wages and permitting one employee to underbid another in quest of a job due to temporary unemployment. Elimination of this inhuman competition can be credited largely to the seniority provisions of union contracts.

Other contributing factors that prevented the recession from becoming a crushing avalanche of depression resulted from unemployment compensation, old-age assistance, and social security.

Likewise, the many pension and welfare funds, made available as a result of union contract negotiations, have been helpful in preventing greater depression as well as a lifesaver to those no longer employed.

History will show that organized labor has always been the strongest advocate of these objectives. They have been accomplished in spite of the strenuous objections of many business people who now benefit from stabilization directly related to contract negotiations and social legislation. We need only refer to previous conditions, that resulted in recessions or depressions, to verify these facts. This experience should be sufficient to obtain the full support of both labor and management in making further improvements. The opportune time for such action is at hand. Unfortunately, the tone of many business spokesmen at this time indicates they will oppose the very measures that have helped to save them from a more serious crisis as recently indicated. Therefore, we must call upon our Senators and Representatives in Congress to take the necessary measures to protect the Nation's economy. This Economic Committee is the logical starting place for a program that will provide that action and will result in the greater protection to all Americans.

On page 14 of his report, the President refers to consumer demands as a most significant factor in the resistance of the economy against recession. On page 15 specific reference is made to union leaders and the wage increases that are the result of negotiations with management. Sober reflection will indicate, to any reasonable person familiar with the facts, that increased incomes are necessary in order to expand this consumer demand. To make it a reality that will work "two ways," without giving consideration to these facts would be to ignore the best interests of all workers and their dependents. Since the cost of living continued to increase during the so-called recession despite heavy unemployment and shorter workweeks, this emphasizes the necessity for further analysis and corrective action. Meaning, of course, reduced overtime and the drastic reduction in jobs and opportunities for advancement to higher paying classifications.

Now that farm prices are falling, certainly the farmer should not be blamed for the continuing high cost of living. Under these circumstances this phase of the national economy must receive fair consideration and assistance as needed. Affiliates of the National Independent Union Council have long recognized that the workers' welfare is closely alined with that of the small farmer and the agricultural worker in this country. We continually seek to strengthen these bonds.

Before placing the blame on labor, for certain alleged inflationary trends, it would be wise to consider the facts with respect to other economic interests. For example: Recent reports indicate that profits and dividends are now rebounding much more briskly from their sharp decline than is unemployment. Almost unnoticed, says one statement, is this roller-coaster-like move of profits, has been the unshakable steadiness of corporate dividends. While many firms trimmed payments, enough increases were voted by others, and enough companies decided reserve justified unchanged payments even though earnings had fallen, to keep the flow of dividend checks to American investors at about the same pace in 1958 as in 1957. During both of these years, as you know, the recession in business took place and so many workers were laid off. The report also makes reference to "stocks and prices." It is common knowledge that stock prices have gone up almost nine times as fast as the dollar has depreciated in the past decade. Much of this occurred during the business recession. That is the startling conclusion that leaps out of a chart drawn by this statistical reporting service. Use of the same 1947–49 base period, as the Bureau of Labor Statistics uses for its "Consumer Price Index," shows that the Dow, Jones average of 30 industrial stocks had climbed by the end of the year to more than 310 percent of its base, while the consumer prices have risen only 123.8.

We do not claim to be infallible authorities on the meaning of all aspects of these facts. However, we suggest careful consideration of them when attempts are being made to legislate morals for labor. We doubt that it can ever be accomplished by legislation for any group. However, there is evident necessity for establishing some ethical practices to regulate business concerns when moving or closing their plants in certain localities. Especially when this action leaves the local economy destitute simply because the company is induced to locate their operations elsewhere due to substandard wages, tax, or similar advantages. By this procedure the company often shirks their responsibility, to the older employees as well as the community largely responsible for the original success of the company.

More attention must be given to curtailing the importation of cheap foreign-made products which constitute such unfair competition for American workers and business.

We recognize that there is merit and logical argument for freedom of trade between the nations. We also realize that economic aid should be given to free nations of the world in order that they might raise their standards of living. But we do not believe that this aid should be rendered to the extent that it will weaken the economy of this Nation and lower the standards of living of our people. Hard-hit industries include automobile, textile, meat and food products, paper, steel, porcelain, petroleum, and others, including the electrical industry, in particular.

To illustrate: Our economy and our national defense are depending on electrical energy. Electrical energy cannot be produced and distributed without turbines and transformers and other related equipment. Such equipment is produced, in this country, by workers who have acquired special skills through long experience. A large part of the cost of such equipment consists of labor, approximately 40 percent. It is not likely that automation will replace these skilled workers. The electrical industry employs millions of workers in this country, plus those who are employed in the various industries which supply the electrical manufacturers, such as steel, copper, paper, porcelain, and many others. The workmen employed in the electrical industry earn substantially high salaries.

We find, however, that the present tariff and foreign trade policies are encouraging foreign manufacturers to sell such equipment in this country at prices so low that competition from an American manufacturer is out of the picture. Even the greater efficiency of the American worker does not make it possible for the American manufacturers to compete with foreign manufacturers who pay their workmen rates that range from 20½ to 62 cents per hour. Compare this to American manufacturers who pay well in excess of $3 per hour on items where 40 percent of the cost is labor.

The Federal purchasing policies require purchase from the lowest bidder. No American manufacturer can compete with the foreign-built equipment under these conditions. Consequently, practically all of this type of equipment is now being made in foreign countries.

This type of foreign policy has caused many of our electrical manufacturing plants to lay off as many as 2 percent of their employees. Some of these plants are situated in depressed labor areas. Of course, there is an allowance for this of 6 percent, but what good is 6 percent to a manufacturer when a foreign company underbids them by 50 percent. Unless this trend is recognized and our electrical equipment industry is given protection from the importation of such equipment, the electrical power system of this country will be dependent on foreign manufacturers; and will put more of our people on the ever-increasing unemployment rolls.

The loss of Government business to foreign manufacturers will affect the unemployment situation more in 1959 than in previous years. The estimated amount of heavy electrical equipment to be purchased in 1959 is approximately 28 percent less than 1958, which in itself was a low year. We are very much concerned about the rise in unemployment this situation obviously will cause in the immediate future.

Electric energy is too vital to the economy and defense of our country to allow foreign manufacturers to have control over the equipment necessary to supply this energy.

We believe that the protection of our economy, and in certain industries, the protection of our country, requires selective tariff protection for those industries in which the labor skills require long apprenticeships and experience. We disagree completely with the trend to displace skilled and highly technical American workers with cheaply paid foreign labor. We have no quarrel with the desire to help the foreign countries which are friendly to us, or which have a political philosophy similar to ours. However, we believe that the American workman is entitled to compete for his livelihood on some fair basis—and competing with labor rates one-fourth or less is not fair competition.

Turbines and large power transformers are manufactured by only six companies in the United States. Much time has been spent on research and development of these products. This research and development and design service of domestic companies has proven to be of great value to our Government in building large and more advanced power systems.

The current Federal policy concerning procurement abroad is dampening the desire, ability, and opportunity of the domestic industry to participate and contribute to the technological advance that Government power activities might involve.

The Government's decision on this matter can determine the survival or destruction of these industries because of the impact of unrestricted imports in the small and limited market for heavy electric equipment. Unrestricted imports will cause the companies engaged in the production of these items to close out or pare down these particular operating divisions of their business because of their unprofitability if they are diversified companies; imports will remove the business basis for their existence in those cases where a particular company is highly concentrated in this area of production.

The importation of heavy electrical equipment from overseas has been the cause of a considerable amount of the unemployed labor in the industry. As of January 1, 1959, my home local, whose members are employed in the transformer industry, has 18 percent laid off. Some of these members have been laid off since January 4, 1957, a period of 25 months. The percentage is much higher in other unions representing this type of worker.

The loss of this skilled labor to the industry is very detrimental to national defense due to the fact that these men cannot be trained in a short period of time. The time required to train a large power transformer winder or assembler runs into years. These units are not production line items. Turbines and power transformers are custom built, and each order usually requires individual designing. Only men with years of practical experience are capable of building these units.

This same skilled domestic labor is also available in time of emergency when rapid repairs are necessary, due to some national emergency, to restore electric power.

The same cannot be said when foreign products are involved, because of the different engineering designs, manufacturing techniques, and units of measure used by European manufacturers, it takes an American manufacturer a considerably greater length of time to repair European equipment than would be the case for one domestic manufacturer to repair his own equipment or even that of another domestic manufacturer. For example, and I quote from the statement made by the National Electrical Manufacturers Association at hearings before the House Ways and Means Committee in February of 1958:

> It has been estimated that it would take two to three times as many man-hours to complete a major repair on a foreign-built power transformer than would be required to complete the same repair on comparable equipment of American design and manufacture. These difficulties are increased substantially when design drawings are not available and are critically compounded during a war emergency.

In many cases, to rebuild a unit would be faster than repairing the old one.

Most of the heavy electrical power equipment, produced overseas and installed in the United States has been purchased by the U.S. Government agencies operating large power systems. In some categories the purchases from overseas sources have become a substantial proportion of the total purchases by the Federal agencies. This practice emerged in 1953 and 1954 and has continued to develop in its intensity.

Study of installation of heavy electrical power equipment produced overseas shows substantial concentration of it already in power supply systems serving the Pacific Northwest, the Tennessee Valley, and the areas in upper New York State served by the Power Authority of New York. Smaller concentrations exist in States in which hydroelectric projects of the Department of the Army, Corps of Engineers, and the Bureau of Reclamation are located.

If this continuing and cumulative concentration of foreign-produced heavy power equipment continues along the pattern of the past few years, rapidly expanding power demands in areas served by these Federal and State agencies will increase these concentrations substantially. In addition to serving essential residential and commercial demands, the electrical energy in these systems of foreign equipment concentration serves many industrial loads important to the national security.

For example, in the Pacific Northwest, and, in particular, the areas served by the Bonneville system, there are users of large blocks of electric energy highly significant to national security from the standpoint of industrial mobilization. Much of the expansion of the electrolytic process industries for the production of aluminum, phosphorus, and titanium is planned for or has been accomplished in this area. It is the home of substantial aircraft production. During a war a substantial shipbuilding industry will be developed to add to that already present in the area. Important installations relating to atomic energy development are already located there.

These industries and many others are concentrated in areas many miles from the large hydroelectric developments which characterize the power systems of the Northwest. High voltage transmission lines carry the power from the plants to the loads. Substations where the power is transformed to lower voltage for distribution are large.

The service rendered by the Bonneville Power Administration in the fiscal year 1956 illustrates the important industrial use of power dependent in part on service provided by Bonneville. In the fiscal year 1956 Bonneville Power Administration sold approximately 39 percent of its power to aluminum reduction mills which comprise 40 percent of the aluminum industry (BPA 1956 Annual Report, p. 25). During the same period Bonneville Power Administration sold approximately 6.5 percent of its power to other industrial customers having high potential for defense essentiality, including chemical and electroprocess industries. Specifically some of BPA's industrial customers in 1956, aside from the aluminum industry, were as follows: Carborundum Co., Crown-Zellerbach Corp., Electro Metallurgical Co., Hanna Nickel Smelting Co., Keokuk Electro-Metals Co., Pacific Carbide & Alloys Co., Pacific Northwest Alloys, Pennsylvania Salt Manufacturing Co., Rayonier Co., and Victor Chemical Works (BPA, 1956 Annual Report, p. 31).

The BPA also serves the Hanford Engineering Works of the Atomic Energy Commission at Hanford, Wash., and, in part, the city of Seattle, which is the headquarters of Boeing Aircraft.

The tremendous importance of the Tennessee Valley Authority's industrial power service to national security is well known. During the fiscal year ended June 30, 1956, TVA sold 30.2 billion kilowatt-hours of electric energy to the Oak Ridge and Paducah plants of the Atomic Energy Commission which represented 56 percent of TVA's total sales. In the same period, 1.8 billion kilowatt-hours were delivered directly to the Aluminum Co. of America. Other major industrial customers receiving direct service were Air Reduction Co., Bowaters Southern Paper Co., Diamond Alkali Co., Monsanto Chemical Co., National Distillers Products Co., Pennsylvania Salf Manufacturing Co., Shea Chemical Corp., Tennessee Copper Co., Union Carbide & Carbon Corp., and Victor Chemical Works (TVA 1956 Annual Report, pp. 1, A41).

Of the 12 billion kilowatt-hours of TVA power used by industry in the fiscal year ended June 30, 1955, a conservative estimate of the amount used by defense-related industries has been put at 9.5 million (hearings on S. 6766 before the Senate Public Works Subcommittee of the Committee on Appropriations, 84th Cong., 1st sess.).

TVA also serves such defense installations as the Arnold Engineering Development Center of the U.S. Air Force in middle Tennessee. The effect of the absence of adequate policy guidance on national security interest in the procurement of heavy electric power equipment will favor continuing and cumulative installation of such equipment produced overseas without regard to national security.

Further extension of minimum wage laws coverage and a substantial increase in the minimum requirements are necessary. Much industry now excluded as being intrastate, as well as the exceptions made for Puerto Rico and the Territories should be remedied.

The President makes reference to technological research and development. We wish to stress the importance of this factor in the lives of every American, and especially to those who work in factory and on farm for a living. We have found that some engineering firms are prone to concentrate more on high-pressure selling of machines and methods that will eliminate men than they are with actual increased production. Unfortunately, there is great appeal to management when they are offered any new machine or method that will result in the elimination of manpower element regardless of cost. We believe that it is evident to all reasonable people that the displacement of manpower alone is not necessarily in the best interest of our country if it simply results in creation of greater unemployment problems. Automation by industry is undoubtedly responsible for a substantial amount of the current unemployment; otherwise current production levels could not have been attained with less workers than previously required. Provisions to rehabilitate and relocate such displaced workers are essential and unless this responsibility is recognized by industry it must be met by law.

Certainly the most complicated machines on earth will not purchase or consume the foods raised by our farmers or buy the products necessary to keep factories in operation. Those responsible for eliminating workers who have given long and faithful service should also recognize their responsibility to train such workers for other jobs they are capable of performing and where there is demand for their services. It will certainly be a most practical application of an extended educational program beneficial to all segments of the economic picture in America.

In the President's summary of the 1959 picture we find that consideration is missing with respect to raising the minimum wage requirements of the Federal law. In order to bring about the realization of the principle of equal pay for equal work it is most essential that this law be amended accordingly.

We wish to stress that our organization opposes any additional legislation that would further handicap small unions. By requiring burdensome filing and elaborate bookkeeping restrictions, totally unjustified since local control keeps them free from corruption, it will certainly discourage American workers from exercising their right of self-organization.

With respect to granting jurisdiction over any phase of the collective bargaining process to the States, until such States have passed adequate legislation that will insure protection of the rights of workers to organize and bargain collectively, we take the position that it would be most untimely. Your sincere consideration and recommendations regarding these suggestions are requested.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Rettig.

The discussion will be concluded by Mr. Michael F. Widman, representing the United Mine Workers of America.

## STATEMENT OF MICHAEL F. WIDMAN, JR., REPRESENTING THE UNITED MINE WORKERS OF AMERICA

Mr. WIDMAN. Thank you, Senator.

My name is Michael F. Widman, Jr. I am here to represent the United Mine Workers of America. It is the feeling of our organization that a careful analytic appraisal of our economy is especially apropos at this time. The increasing military power of the Soviet Union and her voracious appetite for territorial expansion places an ever-expanding burden upon our economy. Further, Soviet economic penetration, the so-called ruble war, poses grave threats to our national security. The preservation of our cherished institutions, indeed, our very national existence, hinges upon the ability of our economy to provide a steadily increasing standard of life for its members. The national resources of this great Nation of ours must be harnessed to provide for all the world an example of free enterprise at work. Our ability to do this forms the cornerstone of the defenses of the free world.

There are over 60 million wage earners in America. Each year thousands of young men and women enter into the labor market. Each of them can represent prosperity or each can represent stagnation. The whole crux resolves to the amount of effective purchasing power held by these 60-odd-million consumers. The vast majority of our breadwinners are wage earners. They are dependent upon selling their services to an employer in exchange for a certain remuneration. Now, what does this money represent? To the employer it signifies cost. To the consumer his dollars are automobiles, refrigerators, washing machines, and footstuffs. To America the sum total is prosperity. Thus, a high-wage level is the basis of prosperity. High wages provide the mass market for American industry. The fact that the American public consumes the vast percentage of its nonmilitary spending is indicative of the economic structure of our society.

In the United Mine Workers of America we have always struggled for high wages. As a proof of that, we submit to you that our miner today is the highest paid production worker in the country. But we have also insisted upon increased productivity in the coal mines. We believe that productivity is the economic lifeblood of our system. Consequently, if the output per man-day goes up, wages may go up, and prices will remain stable. As an example, since 1950 prices of coal have remained relatively stable. In that same period, wages have increased over 50 percent and welfare fund payments are up 100 percent. This in itself is startling. However, when taking into account the extreme inflationary forces present during this same period, the accomplishment of the coal industry is almost miraculous. The coal operators have performed a great service to themselves, their employees, and the country at large by spending the billions of dollars necessary to modernize their mines. We feel that the whole economy may well follow the example of this industry.

Our economy is now slowly recovering from a severe jolt or "recession." The specter of unemployment still remains. Even with our high prosperity over 4 million people are out of work. In 1958, the coal industry produced only 400 million tons, down almost 100 million tons from the previous year. This situation is serious. There need not be and should not be want and privation in the richest Nation in the world. We do not hold that our economy needs periods of "adjustment" in order to advance. We do not believe in cyclical theories of "boom and bust." However, when these situations occur, we propose that private enterprise, where possible, and governmental action, where necessary, should provide for the economic necessities of the Nation and set the stage for recovery. We reject on one hand the doctrine of let well enough alone and on the other, the babblings of those ill-informed and starry-eyed "big brother will care for you" dreamers. We believe that the practical workings of private industry, with the needed assistance of Government, will best further the economic, social, and political interests of our country.

Consequently, we believe our unemployed should receive payments when they are idle due to no fault of their own. Wages may cease, but the necessities of life do not. These men must not be considered wards of charity. If a piece of machinery is temporarily idle because of surplus capacity, it is not scrapped. Rather, it is kept in running order until it is ready for further use. The 4 million men unemployed in our country are waiting to be utilized. We cannot afford to cast them aside. It is our duty to find jobs for them. In the interim they must be accorded a sufficient amount of money to account for their wants.

Another great problem is our increasing number of older people. Our medical science has lengthened the life span of the average American. Now it is up to our economists to insure that these people are able to contribute to and not burden our society. They need jobs. Our employers should not discriminate against them because of their age. When they have finished a lifetime of service to our society, they should not become the objects of charity. We have Social Security which provides a measure of independence for these people. It should be expanded and increased to take care of the ever-increasing cost of living.

All of these so-called transfer payments form a solid floor under the economy. They serve to flaten out any downturn and to avoid a panic. They mitigate the effects of economic phenomena. In doing so they form a valuable adjunct of our economic life.

As most of you know, many of the coal-producing areas in the United States are classed as "depressed." A combination of factors has made both the anthracite and bituminous producing regions centers of chronic unemployment. This situation is bad for the country for many reasons. Many skilled workmen are out of jobs. Their services are being wasted and they have become burdens on the society. The area itself is gradually degenerating into economic stagnation. Blighted areas are springing up all over the country. Each of these represents a retarding influence on our progress. Here is waste. Leaving aside for the moment the human equation involved, our Nation can little afford waste. So, a comprehensive program to help these areas help themselves will soon show beneficial results to the whole Nation.

Since the dawn of America as an industrial power coal has been one of the basic natural resources. Today coal still serves that need. What of tomorrow? With the depletion of many of our valuable natural resources, coal must naturally assume a more strategic position. In power generation alone coal by 1975 will have a market of 500 million tons. The potential in synthetic oil and gas, in chemical products, is staggering. Shouldn't we begin to prepare for this day? Or will it be the same old story of "too little, too late?" We think the era ahead is challenging. But the challenge must be met.

To meet this challenge we propose the adoption of a national fuels policy. Residual or waste oil from Venezuela has displaced over 40 million tons of American coal. In January of this year as against January of 1958, the importation of residual oil dumped on our Eastern markets has increased very materially, notwithstanding the allegation that imports have been put on a voluntary basis. This voluntary system has not and will not work out satisfactorily. As we see the picture now licensing subsidies and bartering arrangements in foreign countries at the expense of American products has practically killed the so-called reciprocal trade policy enunciated by the Congress. Definitely something should be done immediately to correct the situations which are so detrimental to the United States of America.

Now, to get on the question of labor legislation. The press, since the inception of the McClellan committee, has carried reports on labor abuses. Of course, the National Association of Manufacturers and the United States Chamber of Commerce have not exactly been quiet. Public indignation, it seems, demands controls on labor. Of course, of that public over 15 million represent union members. But a careful analysis soon uncovers the real truth behind the "clean-up-labor drives." They are simply the old "destroy-labor movement" in a new coat.

Since the emergence of strong labor unions the American workingman has benefited immensely. A union is the natural result of our society. Because of the terrific power vested in huge corporations, the individual became a mere appendage to the industrial machine. The unions answered the demand of the worker for protection. All nature seeks equilibrium. Power begets power. So the trade labor movement sprung up. It need not have been labor unions as we know them. Worker redress could have been secured through the avenues proposed by Marx and Lenin. So labor unions perform a necessary function. Any attempt to interfere in the valid operations of unions thus is inimical to the general welfare of the country.

It is our position that enough laws exist on the books to take care of any labor abuses. If a union leader is crooked, the police and judicial functions of state are adequate to deal with him. If the man is repugnant to the majority of his membership, why, then they may remove him by constitutional means within the union. We do not believe that the courts, the Secretary of Labor, the Congress, or anybody else can run the United Mine Workers of America better than its own membership. After all, what is democracy? It is the will of the majority. We do not tolerate outside interference in our National Government. Why should we not carry the principle to our voluntary associations. The Taft-Hartley law, of lasting infamy, carries enough guns to shoot at labor. We say that no more are needed. Enforce the existing ones. Do not attempt to legislate morals for labor, or, for that matter, for anyone else.

Finally, we oppose any new restrictions on welfare fund regulation. The United Mine Workers' Welfare and Retirement Fund and the Anthracite Health and Welfare Fund were set up under terms of the National Bituminous Coal Wage Agreement and the Anthracite Wage Agreement, respectively.. These plans were established for the beneficiaries of the funds. Every cent spent for other purposes is lost to the men who need the fund. Administrative costs of the United Mine Workers' Welfare and Retirement Fund are less than 3 percent, while the Anthracite Health and Welfare Fund only amount to 1.15 percent. If new laws are passed, these costs must go up. Again we say enforce existing laws, but do not penalize the honesty of the many for the dishonesty of the few.

We wish to thank you for this opportunity to present our views on the economic picture in America today.

The CHAIRMAN. Thank you, Mr. Widman.

Mr. T. V. Houser, chairman, Research and Policy Committee, Committee for Economic Development, is not present, but has submitted a statement for the record.

(The statement referred to follows:)

STATEMENT OF T. V. HOUSER, CHAIRMAN, RESEARCH AND POLICY COMMITTEE, COMMITTEE FOR ECONOMIC DEVELOPMENT

This statement is submitted on behalf of the Research and Policy Committee of the Committee for Economic Development in response to an invitation from the Chairman of the Joint Economic Committee.

GENERAL POLICY FOR 1959

The American economy has entered 1959 on the momentum of a vigorous recovery from the recession of 1958. Continuation of this recovery and resumption of rapid economic growth without repeating the inflationary upsurge that accompanied the 1954–55 recovery should be major objectives of national policy.

At the same time, we face unusually difficult choices in balancing large, competing claims against the national product—for national security, for assistance to underdeveloped areas of the free world, and for many domestic requirements, including research and education. These problems come to focus in the Federal budget.

As the Nation enters this budgetmaking season, we wish to emphasize four principles that we have found important in many years of study of the Federal budget.

1. The budget should be in balance, or show a moderate excess of receipts over expenditures, under conditions of high employment. This is one of the essentials for containing inflation. It is the counterpart of the principle that the budget should run a deficit under conditions of recession. One of the main safeguards we can now erect against further inflation would be a budget for 1959–60 that will be in balance when high employment is regained.

2. Constructive action in handling the public debt is another important defense against inflation. Sale of more debt with longer maturities to individual and institutional savers will be greatly assisted if the budget is in balance or has a surplus.

3. The essence of sound government is to distinguish between those expenditures that are essential to the national security and welfare and those that are

at most only desirable. Soundness in Federal expenditures means that essential programs are supported at levels adequate to their purposes while other expenditures are held to the absolute minimum or deferred.

4. The revenues needed to cover essential expenditures should be raised by taxes that distribute the costs of government fairly and that interfere as little as possible with economic growth and efficiency.

To reconcile these principles in the present state of the world is difficult. But it is possible if we are prepared to pay straightforwardly in taxes for those Government expenditures that we consider essential.

### PREVENTING INFLATION AS A NATIONAL OBJECTIVE

CED's Research and Policy Committee regards the prevention of inflation as a fundamental objective of national policy.

We do not accept the idea that creeping inflation is desirable, or even acceptable, because there are forces that could convert a creep to a gallop and because even a creeping inflation erodes the value of longrun fixed-money obligations, which are important in our economy, and crucifies the weaker groups in our society.

A rising price level is not essential to real growth and sustained, productive employment. In fact, by distorting the normal incentives for efficiency in business and increased productivity of labor, it may well endanger the sustainability of growth.

Maintenance of a sound fiscal situation and avoidance of inflation is important for the continuing strength and leadership of the United States in the world economy.

There is danger of long-term inflation in this country, but inflation is not inevitable. The Nation can have both stable prices and high employment—if it is willing to adopt the policies required to make them consistent.

We do not have to sacrifice high production to avoid inflation. The only thing we need to give up is an illusion: The illusion that we can get more out of the economy than we put into it, that we can consume more than we produce.

### AMENDMENT OF THE EMPLOYMENT ACT

We support the proposal to include the objective of general price stability in the Employment Act of 1946.

We believe that the time has come for the Nation to commit itself explicitly to the longrun objective of stable prices, just as it has committed itself in the Employment Act of 1946 to the short-term objective of promoting maximum employment, production, and purchasing power. Although it is generally agreed that the language of the act is sufficiently broad to provide the necessary basis for action to keep prices stable, it is our view that it would be worth while to write the commitment directly into the act.

We recognize that a mere statement of the objective will not of itself produce stable prices. But we believe that it would be helpful in several respects.

First, it would help to counteract the view that the commitment to high employment takes precedence over the commitment to stable prices.

Second, it would strengthen the determination of public officials to adopt anti-inflation measures when they are needed.

Third, it would require both the President, in his annual "Economic Report," and the Joint Economic Committee of the Congress, in its report on the President's report, to place greater emphasis on recent and prospective price trends and to discuss in a more systematic manner methods of achieving price stability.

Fears have been expressed that this proposal would precipitate a long and acrimonious debate over the objectives of economic policy which, in the end, might result in a rejection of the stable price objective. However, it is our earnest conviction that a large majority of our citizens do not accept creeping inflation as a way of life and that the Congress will not reject this overwhelming view if given the opportunity. Moreover, we believe that the debate would, in itself, be helpful in clarifying our economic objectives. In fact, if the Employment Act were opened for admendments, we would urge that, aside from stable prices, the objectives of promoting steady economic growth and productivity should also be added to the Employment Act.

### ANTI-INFLATIONARY FISCAL MONETARY POLICY

The Government's chief responsibility in preventing inflation is, through the exercise of its monetary and fiscal policies, to keep demand from rising faster than the Nation's ability to produce.

We should strive to hold Federal expenditures to a minimum consistent with national security and to create a significant budget surplus during periods of general prosperity without continuing, or increasing, reliance upon taxes that seriously impair production incentives. We believe that this would contribute to the longrun restraint of inflation and should be the objective of national policy.

Even with large surpluses, it would still be necessary to use monetary restraint in the effort to control inflation. Public understanding of this elementary but important point is essential, particularly since the subject of money is highly technical. Stated in the simplest terms, fiscal (Government tax and spending), and monetary, restraint must be used together—because easy money can counteract the effect of a tight fiscal policy and a lax fiscal policy can counteract the effect of tight money.

### GOVERNMENT ACTIVITIES AFFECTING PRICES AND COSTS

A number of Government practices outside the general field of monetary and fiscal policy have important effects upon inflation and are commonly overlooked. These include agricultural policy, stockpiling, tariffs, and procurement practices. We are pleased that the importance of these problems has now been recognized, as indicated by the creation of a new interagency committee to study them.

### PRIVATE RESPONSIBILITIES FOR PREVENTING INFLATION

We endorse the President's appeal for responsible behavior by private groups in the interest of general price stability. In present institutional arrangements, there must be an awareness on the part of labor, business, and the public of the national interest in avoiding an increase in average wage rates and average profit margins at rates that are inconsistent with price stability.

### DIRECT CONTROLS

We are seriously concerned over the ill-considered way in which the idea of direct price and wage controls, or of steps in that direction, frequently enter discussion of the inflation problem.

Direct control of prices and wage rates would not be an acceptable solution to the inflation problem. It would seriously impair the freedom and efficiency of the economy and anyway would not, on past experience, serve for long to restrain inflation. In peacetime, the free movement of particular prices and wage rates is the essential source of guidance to efficient production of the things the community wants. In large part we seek to prevent general inflation in order to preserve the significance of these particular price movements.

### BUDGET PROCEDURES

We have not yet completed our study of the 1959–60 budget and are not prepared to make specific recommendations on it. However, there are certain aspects of the budget to which earlier studies by our Research and Policy Committee are relevant.

While there may be disagreement about almost every item in the budget, there can be no disagreement about the need for improved budgetary procedures as essential for rational budget decision making. We strongly endorse the President's recommendation that he be given power to veto individual items in the appropriation bills. We also support his suggestions for better coordination of expenditure and tax decisions in the Congress.

Responsibility for leadership in formulating budget policy rests with the Executive. The President must provide the necessary information on the purposes and relative values of budged expenditures before Congress can decide how much should be appropriated for each of the activities of Government and how much should be allocated for tax reduction. To make this decision properly, Congress should have before it estimates of revenues and expenditures not only in the coming year but also for 4 or 5 years ahead. This is particularly urgent at the present time, and we strongly urge the President to make such estimates available in order to provide the basis for decisions on the budget. The President should also submit, along with these overall budget totals, his estimates of expenditures for each of the major long-term Federal programs, whether they are included in the administrative budget or in the cash budget.

The President should be given the authority to veto individual items in appropriation bills. Under present procedures, the President cannot disapprove one item wthout disapprovng many others and, as a result, too many wasteful expenditures creep into the annual budget.

Congressional procedures should be revised to encourage Congress to view Government spending as a whole and to evaluate the effect of the budget on the private economy. A joint budget policy conference, consisting of key congressional leaders, should be organized to coordinate revenue and expenditure decisions and to set guidelines for the separate tax and expenditure committees of the Congress.

Government must be as alert as private business to reduce expenditures through greater efficiency and technological improvement. To overcome inertia and habit, the Secretary or head of a large agency should have a strong and competent management staff of his own to keep a continuous check on operations. Such a staff can examine operating procedures more critically than can the bureau personnel who are actually directing operations; and it can be more effective in determining whether decisions for improvement have in fact been put into effect. In addition to the continuing activities of departmental management staffs, each large agency should be subject once every several years to a thorough management audit by experts from outside the agency under the supervision of the Bureau of the Budget. The President should submit to the Congress reports on the major findings of these audits and on the consequent action that has been or will be taken to improve efficiency.

## NATIONAL DEFENSE

The size and character of the national defense program is of great importance economically as well as in every other way.

In determining the size of our defense effort, we must distinguish sharply between the limitation imposed by the amount of our total production that we are willing to devote to this purpose, at the sacrifice of other desirable uses of ouput, and the limitation imposed by the consideration that too heavy a defense burden may weaken our economy, and hence our long-term ability to maintain our security.

The amount we are willing to devote to defense is for the public to decide. There is, however, the problem of placing before the citizenry the facts that are necessary for informed decisions to be reached. Frankness and clarity by high Government officials is a requisite. Congressional and private investigations can be invaluable. Improvement in budgetary procedures and presentation, and strengthening of congressional staffs, are necessary parts of this process. But a full and certain solution is not in sight.

Fear that a high defense burden will weaken the economy has been exaggerated and should not be decisive in the determination of the size of a defense budget representing 10 to 15 percent of the gross national product, or even more. There is no factual basis for the notion that we are within reach of or exceeding some "breaking point" beyond which tax-financed expenditures will critically impair economic growth. We can afford what we have to afford.

The retarding effect of taxes on growth comes less from the total size of the taxload on the economy as a whole than from an irrational structure of taxes that bears heavily on some categories of taxpayers that are important to growth, is burdensome to saving, and impairs incentives.

While we believe possible restraints on the size of the defense program have been overstated, this does not in itself mean that the defense program should be stepped up beyond present plans. It is possible that the costs of adequate defense have also been exaggerated.

## THE NEED FOR FLEXIBILITY

The latest available information indicates that unemployment in December 1958 was about 6 percent of the labor force, certainly an unsatisfactorily high figure. However, production has been rising and unemployment declining, and there is a substantial weight of opinion that these trends will continue. Therefore it is now appropriate to tip the emphasis of policy in the anti-inflationary direction. But it is always important to recognize the fallibility of predictions in such matters and to be prepared to deal with eventualities that did not in advance seem most probable.

CED's Research and Policy Committee has continuously emphasized that flexibility is the essence of wise economic policy. Our recommendations for anti-inflationary policy are predicated upon willingness to adapt or reverse them as developing situations require.

The CHAIRMAN. Mr. Reuss, do you have any questions to ask any of the gentlemen?

Representative REUSS. Mr. Chairman, just one of Mr. Fleming of the American Farm Bureau Federation.

What is the position of the Farm Bureau Federation on the recommendations of the President in the "Economic Report" for raising REA interest rates and for a changed system of taxation of the farm cooperatives?

Mr. FLEMING. With regard to the first one, we are recommending no change in the matter of the interest rate with regard to the loans made by the REA to rural electric cooperatives. On the basis of action taken by the voting delegates of the member State Farm Bureaus, we do recommend that study be made as to whether there are, first, improved methods, of getting greater farmer investment in the rural electric cooperatives and, second, other methods, outside of those now available, to improve the availability of funds to the rural electric cooperatives.

Secondly, with regard to the matter of the taxation of cooperatives, we have a long-standing policy in this regard. We supported the act of 1951 designed to establish what amounts to a single-tax policy—which means that the earnings of the cooperative ought to be taxable either to the cooperative or to the individual patron. And, as I said, we supported the act of 1951, which has since been made inoperative by certain court decisions. We are anxious to work with this Congress to clarify the situation, so that the earnings will be taxed either to the cooperative or to the individual patron.

Representative REUSS. The President's recommendation went further than that, however, did it not?

Mr. FLEMING. I do not believe the President's recommendations did go further than that. I think there has been a recommendation from the Secretary of the Treasury in the form of a letter which went further. It would go further than it would appear our policies would go, although we have a meeting of our executive committee this Thursday and Friday to spell out more specifically our reaction to the Treasury recommendation.

The rules which the Secretary of the Treasury proposed are tighter—go further—than the 1951 act, which we did support.

Representative REUSS. Thank you.

The CHAIRMAN. Congressman Widnall?

Representative WIDNALL. The farm subsidy program presents one of the most serious unsolved problems facing the country today, and with the payment of over $1 billion a year just for storage alone, you can conceivably have entrenched interests who are doing the storing exerting an unwholesome influence on continuing subsidy programs. This grows year by year.

Now, I am particularly interested in finding out who speaks for the farmer. I have been down here in Washington for 10 years, and I have heard people say the American Farm Bureau does not speak for the farmer, the National Farmers Union does not speak for the farmer, and the Grange does not speak for the farmer. Could all three of the representatives here give me answers to this?

First, what is the total membership of your organization?

Mr. FLEMING. Should we take the questions one at a time?

Representative WIDNALL. Yes, please do.

Mr. FLEMING. I will be very happy to answer the question.

No. 1, our membership is on a voluntary basis. Our membership is reported each year, by States, and an official national figure is announced. It is just under 1,600,000 families. Our membership is on a family basis rather than on the basis of individuals. Our membership figure includes farm families throughout the 48 States, Puerto Rico, and Hawaii now.

Representative WIDNALL. Would that mean 1,600,000 farms?

Mr. FLEMING. No. This is 1,600,000 families. The matter of controlling the nonfarmer members is left to the State organization. For example, in Senator Douglas' home State, I believe they allow 10 percent nonfarmers—which includes local vocational "ag" teachers and other folks of that kind. I believe they have a limit by counties of 10 percent.

But the membership is essentially all farm families.

Representative WIDNALL. I would like to develop some of those things a little further on by other questions, if you could just answer briefly each question, as I ask it.

With respect to the Farmers Union, what is the total membership of the organization?

Mr. BRADLEY. The approximate figure, in the absence of the exact figure, I should say is around 300,000. That is coming from approximately 27 States. Of course, if we were to think of our membership as total voting strength—and that comprises farm families 16 years of age up to 21, including the mother and the father—that would multiply what we would call our membership numbers. But farm families total approximately 300,000.

Representative WIDNALL. What is that with respect to the Grange?

Mr. BATTLES. Our membership, sir, is made up within the subordinate Grange units, of which there are 7,000, meeting every other week, and these total approximately 850,000 individuals.

Representative WIDNALL. Can nonfarmers belong to your organization?

First, the Farm Bureau.

Mr. FLEMING. As I have indicated, the control of the membership is in the 2,560 county Farm Bureaus. The answer is that nonfarmers aren't prohibited from membership in most counties; however, because farmers want to keep the nonfarmer members a relatively small proportion of the total for reasons of control and purity of membership, they do not allow many nonfarmers to be members.

Representative WIDNALL. Do you have accurate figures as to the number of nonfarmers in the American Farm Bureau?

Mr. FLEMING. No, not precisely. We have the total membership figure for 1958 of 1,576,000 families. But it will be very close to 90 percent of that figure that are farmers.

Mr. BRADLEY. We restrict our membership, of course, to farmers, and we do not have members in our organization other than farmers.

Mr. BATTLES. We would not make that claim, sir. We take in rural people generally, and while a sizeable proportion of our membership is farm in nature, we do have other rural people.

I would raise this question in your mind, as to the definition of a farmer. You see, we may have a full-time farmer who is a member of an organization, and then he becomes a part-time farmer, and then he gets 10 percent of his income from the farm and then 5 percent of his income from the farm, you see. Where do we draw this line? Or if someone moves into the country and becomes a part-time farmer? The question always is a very practical one. Where do you draw the line? Who do you bar from membership?

Representative WIDNALL. Do any of you have any check on duplication of membership?

Mr. BATTLES. You mean between the three groups?

Representative WIDNALL. Yes. Somebody might be a member of the Grange and a member of the Farm Bureau and a member of the National Farmers Union. Do you have any check on who belong to all three groups?

Mr. FLEMING. Not that is definitive.

Mr. BRADLEY. No. I might add to that that in my home State of Illinois, I believe it is fair to say that quite a number of our members do belong to one or more farm organizations.

Representative WIDNALL. How long does a member remain on the rolls after failing to pay dues? Does he still remain on once he has been a member, or does he immediately get cut off?

Mr. FLEMING. The question whether the cut-off date is March 1st or April 1st or May 1st may vary some by States; but I assure you every one of our members paid their 1958 dues.

Representative WIDNALL. Is that true with respect to the Farmers Union?

Mr. BRADLEY. Yes, sir. Our members become delinquent in January each year. That is a voluntary organization. They sign no contracts requiring that they must notify us of their intent of not remaining a member. It is just by voluntary action each year they pay their dues and become members for 1 year.

Mr. FLEMING. Mr. Bradley, whereas that is true in Illinois, that would not be as completely true in some other States, would it?

Mr. BRADLEY. I would say substantially it is true, but there are some involvements, such as cooperative enterprises, which is also a part of the family of the Farmers Union.

Mr. BATTLES. The only way we know how many members we have is the number of dues incomes that we get from our States, you see. So if we receive from the State a fee for a thousand members, that is the number we count in that State.

Representative WIDNALL. Can all of you just briefly tell the committee this: How are your legislative recommendations arrived at? From the top down, or from the bottom up?

Mr. FLEMING. This, Mr. Chairman, is my favorite subject, because we do work religiously, Congressman, at seeking to get the maximum involvement of our membership in the policy decisions.

I received this morning the report on the number of persons who participated personally at the 1958 meetings—local, county, State, and National where policy resolutions were discussed. These were the adult men and women who participated. The report, which I believe, is on the low side indicates that better than 700,000 adult men and women personally attending meetings where the issues were discussed and recommendations made in the 48 States, Puerto Rico, and Hawaii. Over 20,000 meetings were held specifically devoted to the type of question under discussion here.

We have meetings in almost all of the 2,560 organized counties. The process is not perfect, but I get an opportunity to observe at relatively close range all of the organizations inside and outside of agriculture, and as far as the involvement of the membership in the decision making is concerned, I am proud of the Farm Bureau record, Congressman.

Representative WIDNALL. So that on the national level you report the sum total of your findings from your local chapters?

Mr. FLEMING. What happens is that Farm Bureau members come together in the county annual meeting, and by majority vote they decide what they want to do in the county. That action is final so far as county policies on county issues. They also make their recommendations with regard to State and National policies in that meeting. They are not policies—they are recommendations to the State meeting. The county voting delegates come together in the State annual meeting, and there debate, compromise—or, if you prefer effect reconciliations, and arrive at what the policies are going to be for the coming year on State issues. They also decide on what they are going to recommend to the national convention with respect to national issues. Then they elect their State delegates to the national convention. The AFBF Resolutions Committee is composed of the 48 elected Farm Bureau presidents plus 6 elected Farm Bureau women plus a representative of our young people. They meet for several days and make report to the official voting delegates of the member State organizations. The official delegates numbered 161 last December. They write the policies for 1959 that are printed in this little green booklet. I have it right here.

These policies, then, not only become the policies of the national organization but also the policies of the State and county organizations—for, after all, they wrote the policies.

Representative WIDNALL. How does the Farmers Union operate?

Mr. BRADLEY. In the Farmers Union we have an educational process that originates, of course, at the grass roots level among the farmers themselves. Each county that has a local of the Farmers Union is divided into subdivisions of maybe three or four or many locals within the county, so long as there are five members in number, minimum. They have action officials. Each local has an action official known as a legislative action official, organizational, educational, junior, and so forth. They carry on a week-by-week, month-by-month educational function at the county level, where they debate and discuss the issues that affect them. They then form a policy among themselves at the county level and bring that to the State organization. Normally it is one time a year; more often than that, if the farm people feel it is necessary.

The manner that it is brought generally, first, is by the county president, who is a member of our State board. Our State board is the sum total of all of the county presidents. At the annual meeting each year, delegates are selected from each local, based upon their representation, where they come to the annual convention and bring with them the resolutions adopted by their group. That is considered by a program committee that has been selected by the State board. They debate these resolutions and put them in form to be offered to the whole body of delegates at the convention. There again they are discussed and acted upon.

This, of course, constitutes a local and a State function.

We then come together once a year in national convention, where a program committee is selected from among all of the States. They in turn debate and consider the resolutions coming from the various States. And from this we glean what we think is the representative thinking of the grassroots people of agriculture.

Representative WIDNALL. And that becomes your program?

Mr. BRADLEY. That is our program.

Representative WIDNALL. Mr. Battles, what about your organization?

Mr. BATTLES. Congressman, ours is arrived at in about the same way. As I said, we have 7,000 of these units, that meet on the average every other week. Some meet once a month, and some meet once a week, but on the average every other week. And discussion of issues is a part of these meetings, as a rule. And so it is that the local opinions, policies, are arrived at in that fashion, at the meeting.

Then the State policies are arrived at at a State convention, in which all of these units have delegates. These State policies that relate to national issues come to the National Grange. We held our 92d annual session at Grand Rapids this year. And here they are divided up among 12 committees, these positions, as to topics, as they were in the States. They were divided up among committees in the States before they reached the delegate body. But they are divided up at the national session among these 12 committees, and the committees write a report based on the resolutions they receive, their appraisal of these resolutions, and other evidence that may be brought before the committee, and these committee reports are brought before the delegate body, where they are either accepted, sent back, amended, changed, or written into policy.

Representative WIDNALL. Have any of your respective organizations taken a position with respect to a limitation of the amount of subsidy that could be paid any one farmer or farming corporation?

Mr. BRADLEY. Congressman, in the case of the Farmers Union, I am not sure that that has been decided upon completely by our membership. It is in the area of serious debate and consideration, however, and since we will meet in our national convention in March, I am sure that there will be a limitation placed upon how much subsidy could be paid to one farmer.

Representative WIDNALL. Have the other organizations taken a position?

Mr. FLEMING. Yes; I should like to speak to it. I would like to say that our folks have considered this matter very seriously over the years. They are concerned about the principle involved. They question it, because this would constitute national endorsement of a philosophy that we ought to distribute the right to earn politically.

We question whether this is really an American concept.

If you will take a look at the composition of American agriculture, you will discover that 56 percent of all farming units listed as census farms have gross receipts of $2,500 or less. And if you wanted to apply in this country the concept of "fair shares," as developed and refined in Great Britain, you could politically decide that the thing to do was to level all efficient farmers—those who are interested in making a living from farming—down to this minimum.

We have had some experience in this country with this idea as it has become involved in minimum allotments for burley tobacco. Minimum allotments constitute a most dangerous political principle.

In 1943, it was suggested we ought not to cut any burley allotment below 1 acre. In the actual operation of the program in 14 years, we have now leveled the average down to an acre, and we have cut the minimum to a half acre.

And we now have a situation where, in Tennessee, 9 out of 10 of the burley allotments are under what was supposed to be a minimum 14 years ago.

This is a "leveling" device. It is one that, once started, is very difficult to stop, and it will result in low per-family farm income. We are not for that. We are interested in people being rewarded on the basis of their economic contribution to society.

Now, let me hasten to add, Congressman, that we are not in favor of Government programs that cost the kind of money which prompt this sort of question. So what we would rather do is to correct the difficulty rather than set into motion leveling devices like limits on payments or minimum allotments. I am very disturbed about this principle—one I refer to as the "politics of equal shares."

Representative WIDNALL. May I have the answer from the Grange on that?

Mr. BATTLES. The answer is that we have no policy as to a limit in terms of dollars that any one farmer may receive in terms of subsidy. That was your question, was it not?

The answer is that we do not have.

I would like to say here and now, though, that I think, as I said in my prepared statement, that we have gone through an era, here, of 10 years, that is a pretty "sad-sack" operation, whereby we have had sort of a scholastic argument, political to some degree in nature, whereby farmers themselves have been pretty heavily divided over at what level we were going to fix prices on certain so-called basic farm commodities; and these commodities, as a result of any level of fixed price support, have moved into Government storage, as you imply, and have created a terrifically high storage expense, and other expenses. This is a sad situation that we are now confronted with.

The answer is now, I guess: "Where do we go from here in the rural field?"

Three philosophies come to the forefront.

One, get the Government out of the thing and let the prices take their natural course; the argument being there that it will lower prices, with the surpluses and abundance that we have now, and will increase consumption enough and decrease production enough to solve this problem.

Another route is the route of full reliance on Government, with very heavy production control devices to cut back this production.

And the third is some sort of an enabling proposition, commodity by commodity, whereby farmers can do, by commodities, what they have done, say, in the cases of oranges, which is a real good example.

We think that industry and labor and other groups, some of them at least, have certain mechanisms provided by the power of Government that they use to increase their own economic well-being, and that we would like to have them in agriculture. so that we could get off the back of the taxpayer and accomplish this job ourselves.

But the orange people, in short, through a marketing agreement and order device, are able to control the amount and quality of oranges that go on the market. And they have been able to do that for a long while. I think they do the same thing that industry does in controlling its inventory and that labor does in controlling many things with respect to its output.

Now, if this is the general approach that we are going to make, I think it is about time that we get at it. Otherwise, if we are going to fix prices at any level, I am not sure that this expense figure, which I can see you are really concerned about, and all of us are—whether we are going to get it down or not.

Representative WIDNALL. Thank you.

The CHAIRMAN. There is just one question I wanted to ask: For some years, I have been periodically introducing an area redevelopment bill or "depressed areas" bill designed to set up three revolving funds, one to start new industry by making loans up to 65 percent of the value of fixed capital to private enterprise in areas of high and persistent unemployment; and a similar revolving fund to start industries in farm counties, where the average farm employment is low and underemployment is high; and another revolving fund, with low interest rates though above the average of interest on Government rates, to help communities construct facilities such as industrial water and those, which would help bring work and production to the people in these communities so that they would not be squeezed out of these communities and made to turn elsewhere.

I take it the American Farm Bureau is quite decidedly in opposition?

Mr. FLEMING. We continue the same position we took last year.

The CHAIRMAN. I could not quite tell whether the United Mine Workers were in favor of it or not.

Mr. WIDMAN. We certainly are, sir.

The CHAIRMAN. Has the Grange taken a position?

Mr. BATTLES. We are in favor in principle of the area development bill. That is right.

The CHAIRMAN. The Farmers Union?

Mr. BRADLEY. Yes, Senator; we are on record as supporting it.

The CHAIRMAN. I suppose the independent unions have not yet taken a position on this.

Mr. RETTIG. No; we have not. We have a legislative conference scheduled for the first week in March in this city, and I am sure it is a subject we are going to be interested in, and myself, especially, coming from a depressed labor area, St. Louis, Mo., which includes the industrial area of East St. Louis and surrounding cities.

The CHAIRMAN. I hope that the action of the Farm Bureau is not final, and that a process of conversion may take place.

Thank you, gentlemen, very much, for coming.

Tomorrow we meet at 10 o'clock in room 457 of the Senate Office Building, and Mr. W. J. McNeil, who is the financial comptroller of the Department of Defense, is going to speak.

(Whereupon, at 3:26 p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, February 10, 1959.)

# JANUARY 1959 ECONOMIC REPORT OF THE PRESIDENT

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TUESDAY, FEBRUARY 10, 1959

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D. C.*

The committee met at 10 a. m., pursuant to recess, in room 457, Senate Office Building, Senator Paul H. Douglas (chairman) presiding.

Present: Senators Douglas and O'Mahoney; Representatives Patman, Bolling, Kilburn, and Widnall.

The CHAIRMAN. The committee will be in order.

We are glad to have you here, Mr. McNeil. If you are ready, we will proceed.

## STATEMENT OF HON. W. J. McNEIL, ASSISTANT SECRETARY OF DEFENSE

Mr. McNEIL. Mr. Chairman, I am pleased to appear here again as a representative of the Department of Defense to contribute what I can to your consideration of the President's Economic Report. You have already heard the Secretary of the Treasury, the Director of the Budget, the Council of Economic Advisers, and other Government officials who dealt with the Federal budget and the economy as a whole. Therefore, it would perhaps be most helpful if I were to emphasize the defense aspects of the subject.

I would like, first, to take up the third question raised in your invitation to appear here today. The question is as follows:

What criteria were followed in arriving at the total budget proposed for national defense? For apportioning this total among various programs?

I think the answer is basic to a discussion of the economic and fiscal implications of the defense program and budget proposed for fiscal year 1960.

The 1960 defense budget is based on the premise that the Nation's essential military requirements must be met. While, as in past years, each individual service chief has certain segments of his own service program to which he would like to see additional funds allocated, the Joint Chiefs of Staff have gone on record that they consider this budget adequate to provide for the essential programs necessary for the defense of the Nation for the period under consideration.

The budget takes into account what is known about the strength and weaknesses of possible enemies, now and in the future; the strength and weaknesses of our major allies around the world; the international situation as a whole; the present and prospective state of military technology; and the general economic and fiscal situation in our own country. It recognizes that the threat to our national security, and indeed the security of the entire free world, is not only military but is also political, economic, and even psychological. It responds to the fact that to meet this total threat most effectively the United States must have a total national strategy in which each element is brought into proper balance.

Thus, the defense program and budget are not developed in isolation but rather as part and parcel of a total national strategy. I might say, Mr. Chairman, that this is hardly a new approach. The same thing could be said for any of the dozen annual defense budgets with which I have had some personal experience.

The basic objective of our military policy is to deter wars, large or small, by building and maintaining, for as many years as need be, military forces of sufficient strength and flexibility to make it clearly unprofitable for any nation to attack us; and to discourage, or counter if need be, limited aggression in a manner best calculated to keep such hostilities from spreading into general war. To accomplish this objective we need first a nuclear retaliatory capability, adequately safeguarded and ready for immediate action. Second, but equally pressing, is the need for mobile and suitably deployed forces capable of dealing with local war situations. We seek these objectives without in any way overlooking the need for continental air defense and for maintenance of open sea lanes.

Obviously, no one annual budget can assure us such forces all by itself. Each annual budget must be considered as but one increment of a steady, stable, overall level of defense effort which this Nation must support, indefinitely if need be. The fiscal year 1960 budget is a continuation of that effort.

It should be noted that over the last 10 years $200 billion has been made available for research, development, procurement of equipment, and the construction of military public works. That is just in the last 10 years. Thus, each budget provides one additional increment, which over a period of years is a substantial amount.

I said that first we must have a nuclear retaliatory capability, adequately safeguarded and ready for immediate action. Such a force is in existence now and the President's 1960 budget will continue to support such a force.

In the judgment of our principal military leaders the manned bomber is still the principal means of delivering the large nuclear weapons in the volume and with the accuracy needed to strike a decisive retaliatory blow. In this respect the United States has a force far superior to that of our principal opponent, both in numbers and in overall combat capability. The United States intends to maintain this superiority during the period ahead, as evidenced by the 1960 budget, which includes substantial funds for the procurement of additional B-52 intercontinental jet bombers, B-58 supersonic medium jet bombers, and the supporting jet tankers.

Also included in the budget are additional funds for the Hound Dog air-to-ground "standoff" missile which will greatly enhance the capability of the B-52 to penetrate enemy defenses. The program to improve the protection and shorten the reaction time of our manned bombers through base dispersal and the construction of alert facilities is now well advanced with funds appropriated in prior years. Additional funds are included in the 1960 budget to carry on this program as well as for the new ballistic missile early warning system which was started last year. Even if no strategic warning were to be received, this new system is designed to provide that vital period of time needed to get a significant proportion of our bombers into the air and on their way to the targets. These are some of the reasons why our military leaders feel that regardless of who might strike the first blow and regardless of the number of ICBM's an enemy might use against us, this Nation will continue to have a retaliatory force sufficient to strike a decisive blow.

At the same time the Defense Department is pressing forward with the development and production of our own long-range ballistic missiles. The 1960 budget includes funds not only for the Atlas, which is already in production and which will be in the hands of the forces in limited numbers by the end of this year, but also a follow-on liquid fuel ICBM, the Titan, and a solid fuel ICBM, the Minuteman. Thus, the 1960 budget includes substantial funds for three generations of ICBM's.

Also included are additional funds for the Polaris program—a submarine-launched intermediate range solid fuel ballistic missile. Six Polaris submarines are already under construction, three more will be started next fiscal year, and funds are included in the 1960 budget for long leadtime components for an additional three submarines. The first of these submarines is scheduled to go into operation next year.

There are additional elements of our retaliatory forces which have yet to be mentioned. The carrier task forces with their aircraft, for example, are capable of delivering nuclear weapons over considerable distances. There are also nuclear-capable U.S. tactical air forces and missile units deployed at forward bases in various parts of the world. All of these contribute to our diversified deterrent and retaliatory strength.

As remarked earlier, second, but equally pressing, is the need for forces capable of dealing with limited war situations. Except for certain forces specifically developed for retaliatory or continental air defense, there is really no logical way to separate general and limited war capabilities. Nevertheless, it is estimated that somewhere between 60 and 65 percent of the total defense budget is devoted to forces particularly suitable for limited war situations. Of course, all forces are usable in general war.

The CHAIRMAN. Is it not true that by the end of this year, you will already have reduced the number of men in the Army from 900,000, which it was a few months ago, to 870,000, and the number of men in the Marine Corps from 190,000 to 175,000, and that as a result of these cuts, the number of Army divisions will have to be reduced from 15 to 14, and that many of the Marine units will be under strength?

Mr. McNEIL. You are correct, sir. The reduction in the Army this year is 900,000 to 870,000. There would be a reduction of a division in the Army. In the case of the Marines, the reduction would be 188,000 to 175,000, but for the next year there are no further reductions planned.

The CHAIRMAN. Is it not true that Congress added to the defense budget last year $1 billion, and in the statements of the Senate committee which added the $1 billion, later approved in conference, it was specifically provided that these funds were to be used to keep the strength of the Army at 900,000, and to raise the strength of the Marine Corps to 200,000?

Mr. McNeil. That is correct, sir.

The Chairman. Therefore, despite the appropriation by the Congress, and specifically at the request of the Senate and not reversed by the conference committee, the cut went through.

Mr. McNeil. That is correct, sir. That was a determination by the President, although the strength at the beginning of the year in the case of the Marine Corps and the Army were generally maintained through a period up until October of last year.

The Chairman. I realize you are not the policymaker in this respect, and I do not hold you responsible for it. I am privileged to say as one Senator that I regard this as a lamentable decision, greatly reducing our ability to fight limited wars. While I certainly do not question the patriotism of those who made the decision, I think it is one of the biggest mistakes that our defense authorities and the President have made. As we all know, total war will be so frightful that there is some deterrent for the Communists not to initiate one, and what they may do is to nibble away at the free world on the periphery, and there we will be reluctant to use nuclear weapons because if they are used, they may touch off a world war. Therefore, it seems to me that we must have a high capacity for limited war as well as total war. The great advantage of conventional weapons and ground forces is that we can confine the use of force to the areas immediately affected and operate as a surgeon's knife to cut out the affected areas with a minimum of damage to the surrounding organism and the surrounding society. As I say, I know this not your decision and what I say bears with it no personal reproach to you. But I think the Nation should know the decision that has been made. I think when it does know this, it will conclude that it was a great mistake.

I think, incidentally, there is a very important point of constitutional law involved, namely, whether an appropriation by Congress specifically made for the purpose of maintaining an Army of 900,000 and a Marine Corps of 200,000 can be overridden by Presidential fiat. I was not aware of the fact that he had the item veto as an ingredient of the budgetary process. Congress has steadily refused to put that into effect. Yet here we have the President carrying out an item veto on an important element of national defense.

Let me say that I am well aware that President Truman did the same thing in connection with the Air Force in the late 1940's, so that should be taken into consideration. Nevertheless, I think it is a usurpation of power by the Executive, and I would feel myself remiss if I did not call public attention both to what I regard as violation of the Constitution and as a great weakening of the defenses of the country.

Mr. McNeil. I think, Mr. Chairman, there would be general agreement on the views you expressed—that we have to take care of these limited war situations. The difference, of course, is just what it takes to do it. I did want to bring out the point that of our total spending in the Department of Defense of about $41 billion a year—that is, net expenditures of about that figure—60 or 65 percent is for forces specifically designed to be usable in limited war situations, which is a fact I believe, that a lot of people are overlooking.

The CHAIRMAN. I know you are a very able comptroller, and of course we will accept your word for that. We should certainly be aware of the fact that Great Britain has shifted its defense emphasis very markedly as well. Great Britain formerly had a highly efficient professional army backed up by territorial reserves comparable to our National Guard, but she has been decreasing her conventional forces under the Sandys plan, and throwing almost her entire emphasis on missiles.

You are also aware that the French Army has been largely absorbed in Algeria, and they have withdrawn troops from the western front which I think have not yet been restored. So there has been a very marked weakening of limited war defenses of the free world.

When you have the United States joining this retreat, I think it creates justifiable grounds for deep concern on the part of citizens.

Mr. MCNEIL. In the next paragraph of my prepared statement I touch on that facet. Suppose I read the next two or three sentences, and then come back to that point, if I may, Mr. Chairman. I was going to say—fiscal year 1960 will be the first year since the end of the Korean war in which no significant reductions are scheduled. As you know, the Defense Department has followed the policy during these years of reducing military personnel as new and more powerful weapons were integrated into the forces. Although the flow of new weapons to our forces will continue during 1960, it seemed prudent to the President and his advisers to keep the forces at about the level planned for the end of the current fiscal year in view of the Communist policy of deliberately and constantly probing the free world position to test our determination to resist aggression.

What I wanted to add at that point is that many of the new weapons that have been developed have been of improved types for use in limited war as well as the more powerful big weapons for general war. That is true in the missile field, aircraft, or other weapons.

I cannot in this brief compass cover all the aspects of the defense program. Let me simply say that the 1960 budget provides funds for continental air defense, tactical forces and naval forces, at a level consistent with their respective missions and the character of the threat as it is now evaluated.

We have discussed, in general terms, some of the criteria which, when translated into people and material, determine the allocation of funds to individual programs. With respect to the major weapons programs two specific principles were applied. As Secretary McElroy pointed out to the House Appropriations Committee about 2 weeks ago:

> We are living today in an era of extremely rapid advances in science and technology. Some of the programs which apeared to have had great merit only 12 months ago, now, in view of the progress made on more technically advanced projects, no longer have the same importance or urgency. In developing the fiscal year 1960 weapons programs, therefore, we have followed two basic principles:
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> 1. Where a program is considered to have unquestioned essentiality the rate of development has been maintained and, where advisable technologically, has been advanced.

2. Where a program, in view of current technical information, now seems to be of lesser importance or has been overtaken by events, the level of effort has been reduced or the project eliminated entirely.

This policy will not only enable the Department to get more defense out of each dollar spent but will also, by concentrating effort on the more advanced and more promising weapons systems, achieve the greatest overall progress.

As a result a number of programs have been or are being phased out or canceled. These include the Regulus II submarine-based cruise-type missile, the Redstone liquid fuel tactical missile, the P6M jet seaplane, the F8U-3 all weather ship-based fighter, the Goose decoy missile, the Dart antitank missile, and so forth. On the other hand, work is being pushed on development of such advanced missile systems as the Nike-Zeus antimissile missile, Pershing solid fuel tactical missile, Polaris, Titan, Minuteman, and so forth, and on such aircraft as the F-4H-1 ship-based all weather fighter, B-58 supersonic bomber, and so forth. Funds have also been included to continue work on the development of the B-70 intercontinental supersonic bomber, F108 long-range supersonic interceptor, the nuclear-powered aircraft, and a number of other advanced weapons systems.

The CHAIRMAN. If you will permit another interruption, you say, "On the other hand work is being pushed on such advanced missile systems as the Nike-Zeus antimissile missile." In the morning Washington Post it is reported that Major General Beach told the House Space Committee that the Secretary of Defense is turning away from the development of the Nike-Zeus antimissile missile. Such details of the problem of defense are not for our committee to go into, but I merely want to point out that here we have a statement from you, made in good faith, I am sure, and a directly contrary statement on the preceding day made by the man who is Chief of Army Special Weapons and Director of Army Air Defense.

Mr. MCNEIL. I will be glad to touch on that, because it is one of the problems we have in developing any kind of defense program in any year, and, of course, the defense budget. I think it is rather healthy inside the building if the proponents of each of the major systems are vocal and press for their adoption because only then can they be sure to get the right consideration. In the case of the Nike-Zeus, I know of no single program in which probably more time or talent was spent this last October, November, and December trying to determine what should be done. It was not just done by budgeteers; it was by people with probably the best scientific background in the field. The conclusion was reached that nothing should be spared in putting money on the development of Nike-Zeus system but that it was not ready to go into production. That is the essence of the story this morning. There are some people who think it should go into production, although the people best capable of judging advised that we ought to put more emphasis on development before we start manufacturing. That is how simple that story is this morning.

The CHAIRMAN. In other words, when you said that work is being pushed, you were referring to development?

Mr. MCNEIL. Yes, sir.

The CHAIRMAN. And not production.

Mr. MCNEIL. Every dime that the people quite capable in the field felt should be spent on the Nike-Zeus in development this year is in the 1960 budget, but not for production or construction of bases, because we are not that far along.

The CHAIRMAN. In other words, it is money spent for research and development of a prototype.

Mr. McNEIL. Yes, sir. I said no production. There is even work on trying to develop certain machinery so that if we do go into production we will speed the thing. It just is not ready, so we are advised by quite an able scientists group. I want to emphasize that I think there were probably as many hours spent on this item as any other single thing.

It is all of those factors, Mr. Chairman, that I believe are the type of things that should be considered in answering your question:

What criteria were followed and what were some of the basic elements in determining the allocation among various programs?

I would like now to turn to the economic aspects of the fiscal year 1960 defense program and budget. As I mentioned last year, there are three fiscal measures of the defense program:

Appropriations or new obligational authority—the funds granted by the Congress each year.

Obligations—a measure of the level of new activity planned for the year—people to be employed, volume of contracts to be placed for goods and services, and so forth.

Expenditures—the total of payments made during the year for personnel costs and for goods and services received, regardless of the year in which the goods and services were ordered.

While there is no exact relationship for any one year between these three sets of figures, higher appropriations and higher planned obligations forecast increased expenditures; lower appropriations and lower obligations forecast lower expenditures. It should be noted, however, that obligations normally exceed both new obligational authority and expenditures, particularly in the Department of Defense, chiefly because receipts from the sale of existing assets to the military assistance program are available for use for the military departments' own programs.

These receipts are applied as a credit against the gross expenditures of the military departments. Thus, the net expenditures reported understate the actual amount spent by the services on their current programs. The degree of understatement, however, is fairly constant from year to year so that the net expenditure figures are still a good measure of trends in the defense program. Nevertheless, obligations are perhaps the best overall measure of the current defense program.

Total new obligational authority requested for fiscal year 1960 amounts to $41,190 million, including $340 million to be derived by transfer from the revolving funds of the Department of Defense. These revolving funds, by reducing inventories, are able to generate credits in excess of their needs. The excess credits can either be returned to the Treasury or made available for other defense purposes, as the Congress may determine. Incidentally, I understand when the Director of the Budget appeared before this committee, it was suggested that the Defense Department should draw down stocks for current use and reduce new purchases. We are trying to do this wherever possible. For example, in one area—consumption type goods financed under revolving funds—a total of about $5.3 billion will have been returned to the Treasury or authorized for transfer to other defense purposes in lieu of new appropriations since the end of the Korean war.

The CHAIRMAN. If I may interrupt again, you touched on an extremely important point which I raised with the Director of the Budget when he appeared before us. I have here the report of the Dawson committee of the House, and the figures there shock me. They show that in the Department of Defense as of June 30, 1958, the supply system inventories had $44 billion left in distributed stocks. Peacetime operating stocks were $14.5 billion, and the mobilization reserve $12.1 billion, which would seem more than ample for both peacetime and mobilization purposes, but in addition had in economic retention $5 billion; contingency retention, $1 billion, and excess stocks, $10.4 billion. These last three categories certainly seem to be excess. They come to about $17.5 billion. Then there is a very elaborate classification by branch of the service which holds these excess stocks and the type of stock, which I will not go into, but which I have studied in some detail.

May I say that we have a very high opinion of you, Mr. McNeil. I have been watching your work ever since I came to the Senate 10 years ago. I know of the many economies which you have instituted.

Mr. MCNEIL. Thank you.

The CHAIRMAN. I cannot help but be shocked at these figures. It does not seem to me that the Department of Defense has really discharged its responsibility when, as I understand it, only some $340 million of these stocks are to be drawn down this year. It would seem to me that a large proportion of these excess stocks could be used for home-based forces for training, and that instead of constantly purchasing substantially similar equipment, these excess stocks should be worked off. This is all the more shocking, I may say, at a time when the Department of Defense is allowing the Army and the Marine Corps to be reduced in size in order to save a billion dollars which has been appropriated. Although I am not competent to deal with the subject, certainly many experts believe that our missile development has been allowed to lag. This is, I think, one of the major questions that Congress, the administration, and the country must face; namely, whether or not it is possible to make enormous economies by reducing this surplus stock.

I may say in this connection I have reports from the Comptroller General, which we have gone over, dealing with the procurement of the J–57 jet aircraft engines in which they charge the Air Force made unnecessary expenditures of $16,430,000. There is another report which I have here, "Deficiencies in Management of Requirements and Control of the Related Procurement of Hi-Valu Aircraft Spare Parts of the Sacramento Air Materiel Area Office," which charges a waste of $2 million. There is a letter to Speaker Rayburn on hand grenades showing destruction of hand grenades at a waste of $20 million. There is a report on the review of selected activities of the ship parts control center, Mechanicsburg, Pa., citing that approximately 50,000 low cost ship repair parts of low demand in the country could be eliminated with a saving of approximately $1.6 million annually.

There is another report relating to procurement of ground communication electronic equipment at Rome, Italy, depot, indicating a waste of $1.4 million; an examination of the U.S. Army Signal Supply Center of Yokohama, states that they overstated requisitions, amounting to over $8 million. Review of the activities of the Supply Department, Naval Air Station, Pensacola, Fla., does not indicate a money waste but inadequate procedures. I have a pile of others which I will be very glad to leave with you. These are only partial checks. It is impossible for the Comptroller General to audit every expenditure. These are just sample checks. Almost every time he sends out his investigators, he finds things of this type. As I say, I think you are a completely conscientious public servant, and I am not indulging in personal criticism, but there is terrific waste here.

Mr. McNeil. Mr. Chairman, you are touching on one of the really big business-management jobs in this country—how to get things like that under control and still insure having enough to do the job if you are called on to do it. Terrific effort is being put on this problem. True, of the several billion dollars of stores, there is not any question that at times we have bought too much, that we still have too much, and that we have not gotten rid of it early enough when we overbought. Some of the overbuying is a result of basic progress in the business. For example, we overbought on some engines in 1951 and 1952. Fortunately, I think, we tried to recover and did recover the larger part of what could have been a very big waste. When we first started to buy a new jet engine, the number of hours it would run without overhaul was about 100 hours. You had to buy about 2½ engines for spares for every engine you installed—to keep the aircraft working around the world. As they improved the engine in 2 or 3 years, it was found that you could run it for 600 hours without overhaul. You then needed only 70 percent spares and your original criterion left you with excess engines and spare parts.

You probably read about a big cancellation of about $400 million in planned procurement of engines some years ago. That was an effort to try to bring up to date our criteria. As the engine improved, our requirement for spares dropped sharply. Yet we still have too many engines of that particular variety. As it turned out, the engine was improved faster than we could cut back the orders.

Of the inventories that you just spoke about, a great part of them are of World War II vintage, such as ammunition and spares for guns built during World War II that have not been disposed of and for which there is no commercial market. Some of the inventory is material that was perhaps purchased but not consumed during the Korean war—that still might have a potential use, and should not be disposed of. But the $340 million that I spoke of applies only to consumption-type material that is carried in our revolving funds. It would not cover, for example, trucks used out of inventory. It would not include ammunition used in training which is not carried under revolving funds. So we are using large quantities of material from inventory to carry on the regular activities of the Army, Navy, and Air Force that are not reflected in the $340 million transfer from the revolving funds.

I mentioned early in this statement that about $200 billion had gone into research, development, and procurement of equipment in the last 10 years. A little of that was consumed in the Korean war, but only a very little. Some of the aircraft have become obsolete. You can't keep on buying at an annual rate of $20 billion and not have a big surplus disposal problem every year. You just can't do it.

The CHAIRMAN. Mr. McNeil, I think much of what you say is true. But on the other hand, take, for instance, only one branch of the service, the Department of the Army. It had as of June 30, 1958, just in clothing and textile materials outside of the peacetime reserve and mobilization reserve, $550 million. In the Department of the Navy the same classification is somewhat more difficult to determine. Then in the Air Force there is a similar item. Excess stocks of gasoline were certainly not made obsolete. Trucks, which are certainly not obsolete. I see no reason why trucks of some years past cannot be used in home stations. The boys can learn to drive a 1947 model truck just as well as the 1955 model.

Mr. McNEIL. That is correct. I would be the last one to say we are doing everything perfectly. I believe you will find that there has been some tremendous improvement in the last 10 years in the management of inventories. You must remember that we were left with tremendous quantities of materiel from World War II.

The CHAIRMAN. You did not always have the advantage of similar studies by Congress in the past years, but for years some of us, Congressman McCormick, Senator O'Mahoney and I, have been urging a common catalog, and also urging that some items such as medical supplies, quartermaster food, and so forth, should have a common supplier instead of each service having its own system of supply. I must say that the reports which we get are very ambiguous as to the degree to which the services are actually carrying out these mandates which Congress has repeatedly given, beginning in 1951.

Mr. McNEIL. Mr. Chairman, in the case of food, clothing, medical supplies, the items you listed, we now have only one agency, handling the wholesale purchase, storage, and distribution. The only items in those classes that are handled by the individual services are at the post, camp, and station, or the retail level. I think we have made real progress right along that line.

The CHAIRMAN. How many new items of central supply have you initiated in the last 2 years?

Mr. McNEIL. We are trying to make the first five work, I believe, sir. There are single managers for food, clothing, petroleum, and medical supplies. We are still working on photographic equipment, which is the fifth.

The CHAIRMAN. That is also an important area.

Mr. McNEIL. It is.

The CHAIRMAN. That is one which would lend itself to this system.

Mr. McNEIL. That is what we thought, but it is not lending itself as easily as we originally thought.

The CHAIRMAN. I am acquainted with the fact that each service wants to keep its quartermaster under its own control and fights like the very dickens to have any pooling. You have my sympathy.

Mr. McNEIL. Thank you, sir.

The CHAIRMAN. I think you also need congressional backing of a much sterner nature than we have put into effect in the past to enable you to carry through these changes. Have you any suggestions as to how we can be more stern with you?

Mr. McNEIL. I think you have been doing a pretty good job of it, sir. Your interest has helped.

The CHAIRMAN. We have passed resolutions and amendments. We have put statements in reports, but in the last few years there has been no progress.

Mr. McNEIL. Mr. Chairman, this is said partly facetiously. I think a good many of our people have probably spent 60 percent of their time during hearings resisting more money instead of trying to get more money in the last few years. It is a bit difficult to resist getting more money and then not spend more money.

The CHAIRMAN. You are in an enviable position. I don't want it to be inferred for a minute that this is a criticism of you.

Mr. McNEIL. I understand.

The CHAIRMAN. It is a criticism of the Department of Defense. I only wish we could have the Pentagon brass here before us.

Mr. McNEIL. Incidentally, Mr. Chairman, I took the liberty of asking two people who are on the staff of the Assistant Secretary for Supply and Logistics to be here this morning, and if there is some specific question on the inventory supply matter that you would like to go into, I think they might be able to contribute. We are ready to go into it as deeply as you might wish.

Representative WIDNALL. Would the chairman yield? Mr. McNeil, wouldn't the Defense Department be able to do a more effective job of cutting costs if they were not subject to the importunities of Congressmen to keep contracts, not to phase out various developments but often to maintain an operation that becomes not obsolete but uneconomic in a particular area? Couldn't a great deal more be saved if you were able to fight off some of these problems?

Mr. McNEIL. That is true, sir. Yet I think the people in the Department of Defense realize the problem of the people on the Hill, and we try to make the "machine" work. I know in the Navy, right at the present time, they are attempting to reduce or eliminate about 45 or 50 activities they feel no longer fit into the requirements of the Navy. Secretary Gates is spending a great deal of his time, not necessarily with congressional delegations, but with chambers of commerce or other local groups, which is perfectly natural. It is probably part of the business.

Representative WIDNALL. I think there has been a great deal more of that in the last couple of years on the part of both management and labor coming down here insisting that they have to have projects continued in order to keep employment in the area. Certainly in some instances you realize it could be done for less in some other area and at a considerable saving to the taxpayer.

Mr. McNEIL. That is true. It has been particularly a problem in the last few years with the terrific changes in the type and character of the weapons systems that are coming in to use. Last year before this committee, I mentioned that 75 percent of our procurement dollars were going for items which we could not buy in production quantities in 1955. Over just a 4-year period, this is quite a startling change. Whenever you have a change of that kind there are facilities that are no longer needed and must be phased out. At the same time new requirements will be generated for different facilities at other locations. When there is public resistance to it, it can be an expensive proposition, and we can't save as much as we might otherwise do.

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The CHAIRMAN. I quite agree with what Congressman Widnall says. We too are sinners in this respect. But it is always much easier to correct the other man's sins than to correct your own.

Mr. McNEIL. These studies are made by Congress, by Appropriations Committees, by the Comptroller General, and by our own auditors, and I would like to think we are using them to try to correct and improve the business to the extent we can. We are certainly not asleep, but we are not doing it as fast as we probably could.

The CHAIRMAN. May I say that I only regret that Secretary McElroy has his time absorbed in testifying before other committees. I would like to get him up here and read a lecture to him as a Dutch uncle would talk to him. But I am afraid he is being lectured to at great length by other committees, and I don't want to add to his burden. He might take administrative notice of our feelings in this matter which I think the committee as a whole subscribes to.

Representative KILBURN. I heard a short time ago President Eisenhower say something that impressed me very much. He said in effect this: Of course, we want to defend this country against any eventuality, surprise attack, total war, limited war, anything. He said when we have done that—and he feels, I gather, that we are in that position now—then an extra dollar spent is wasted, because we don't want to arm ourselves for the sake of arming. We want to arm ourselves to defend ourselves against any eventuality. So I don't know much about this subject, Mr. Chairman, but it does seem to me that there are lots of carping criticisms coming to the Department of Defense and President which perhaps come from people who are not fully informed about our defenses. Of course, the Congress should go into the matter very thoroughly. I am in favor of that. But the goal that the President is seeking, it seems to me, is a sound one.

Mr. McNEIL. I think it is. I think most people agree. The difference gets down to 1, 2, 3, or 4 percent in judgment as to the level at which defense should be carried on.

The CHAIRMAN. May I say that I am not proposing that the total appropriations for the Department of Defense should be reduced. Not at all. I think they should be maintained and possibly increased. What I am saying is that the millions of dollars wasted, tens and hundreds of millions, in excess stocks, could be saved, and then used to strengthen the actual combat forces, and to strengthen the Army, Marine Corps, develop missiles to the degree that the experts think they should be developed, and remove this financial difficulty which has operated to put a damper on our defense. That is really my point. I am anxious for more defense.

Representative PATMAN. Mr. Chairman, would you yield?

The CHAIRMAN. Yes, sir.

Representative PATMAN. I agree with the chairman that Secretary McElroy should be here. I have a high regard for Mr. McNeil. I have never known him personally, but I know something about what he has done and his reputation is good. It occurs to me that we should, however, have the person who is making the decisions before this committee. I wonder if this statement, Mr. McNeil, has been approved by Secretary McElroy?

Mr. McNEIL. Not this individual statement, but every paragraph in it has been discussed, and it is strictly in line with his views.

Representative PATMAN. You can state that you are speaking for the Secretary?

Mr. McNEIL. Yes, I can.

Representative KILBURN. I agree with you that we should eliminate all the waste there is, but I can see what they are up against as these weapons become obsolescent so quickly.

The CHAIRMAN. I understand, but if you go over the items you find there are excess stocks in other items than weapons: clothing, food, electronic equipment, gasoline, spare parts, and so forth. Frankly, the $27 billion is far in excess for peacetime needs and mobilization reserve, and is far in excess of anything we will need in any war we are likely to have. Granted that is an accurate characterization, to have $17 billion additional stocks in excess of the $27 billion is shocking.

Mr. McNEIL. Mr. Chairman, you must remember that much of this material that is now classed as excess and even economic retention is equipment that was bought in World War II and is no longer in inventory in very large quantities in the Department. Since we don't want to throw it away, it is kept in "economic retention." Some of this inventory probably will never be used. For example, there are probably bearings and washers that will never be used to repair World War II jeeps. Yet, since we have a few of these vehicles left around, we retain these spare parts because it is more economical than disposing of them now and having to purchase them later.

Another thing is this: A few years ago Congress used to provide money to buy aircraft spares at a rate of about 50 to 70 percent of the cost of the new aircraft. That led to overbuying of spares before you knew the type and character of the spares you would need, and their wear-out rate.

Last year we had worked it down so that the initial purchase of spares was equivalent to 30 percent, since we had a better feel of what was going to wear out before we purchased. That helps this problem very much.

In the budget this year we are asking for spares money for 20 percent of the value of new aircraft in order to get a better feel of it. Those are the kinds of steps that are being taken to avoid excesses in the future.

The CHAIRMAN. I don't want to pursue this at great length but I merely say that page 102 of this House report indicates the excess stocks and those for economic retention, both of which are really excess, total $557 million for clothing and subsistence. While it is hard to get comparable classifications for the Navy and for the Air Force, there is every reason to believe that there are enormous amounts there, too. Certainly you can wear a 1945 set of dungarees while you are on duty in 1959. While perhaps you need new sets of dress uniforms you certainly do not need to wear dress uniforms all the time.

Now let me ask another question. Is it not true that Congress appropriates for the stock funds but each service must then seek an additional appropriation to draw down these funds, thus requiring a double appropriation?

Mr. McNEIL. No, not a double appropriation as far as the taxpayer is concerned. If you were just starting a stock fund, yes, you would provide credit for the stock fund, or cash. From that time on, however, it becomes a revolving fund. The Congress appropriates funds for the consuming activities of the Department of Defense and they in turn buy from the stock funds. With the funds received from their customers the stock funds replenish this stock by purchases from the civilian economy.

The CHAIRMAN. Does it need an act of Congress to permit the service to draw on the stock fund?

Mr. McNEIL. To draw material from it, yes. The Congress must appropriate funds for the services.

The CHAIRMAN. Isn't that somewhat cumbersome?

Mr. McNEIL. No, operating a revolving fund is very much like operating a merchandising business like Sears, Roebuck or Montgomery Ward. A certain level of material is kept on the shelf available for sale as needed, for any purpose of any of the services. I think Congress has much improved control over the use of inventories, if you want to call it that, by appropriating money to the military departments' maintenance and operation accounts which permits them to purchase or withdraw from store such items as paint, spare parts, lumber, or whatever they require for current consumption and which this Sears, Roebuck type of activity may be carrying in stock. It is the only way I know that you can do a good merchandising job on consumption-type material—that is, to carry it in a revolving fund. While the Congress has to authorize and set up the revolving fund account in the beginning, from then on it is self-liquidating as the stocks are turned over.

The CHAIRMAN. The Congress has to authorize withdrawals by specific appropriations, too.

Mr. McNEIL. Yes. In the past few years we have in effect reduced the inventories in our consumption-type revolving funds and the Congress has been able to withdraw about $5.3 billion in cash from these funds, which is certainly along the lines you were advocating a few minutes ago. It is positive evidence that we have been reducing inventories. The inventories remaining in those accounts are probably about $9 or $10 billion.

The CHAIRMAN. You mean that is in excess of the wartime reserve?

Mr. McNEIL. No, it includes everything. That is in the revolving fund accounts alone. So far we have generally included in our revolving fund accounts only consumption-type material, such as lumber, paint, nails, spare parts, and things of that kind, but not ammunition, trucks, et cetera.

Representative KILBURN. Mr. Chairman, I am just seeking some information that I am not clear on. We have a Joint Committee on Defense Production setup. Does that committee have you before them?

Mr. McNEIL. No, they have not.

Representative KILBURN. What do they do?

Representative PATMAN. Senator Robertson was the chairman in the 85th Congress, and we have not had an organizational meeting this year, but under our rotation system Congressman Brown of Georgia will be the chairman this year. We just have not had a meeting.

Representative KILBURN. Is that committee supposed to look into this very problem that Senator Douglas is raising?

Representative PATMAN. I would rather that the chairman of the committee would speak to that but certainly it would not be very far afield if it did.

Mr. McNEIL. Senator Douglas, to make economy work in any Government operation or any big business, such as Defense, you have to have a system where human nature starts working for you instead of against you. I think you will find that if this consumption-type material is carried in revolving funds, such as our stock funds, people watch with a bit more care what they draw from store since they know that the cost of the supplies is going to be charged to this year's appropriation and the operating allotment for their station this month. It is just that simple. You don't get supply discipline if all you have to do is to have the lieutenant tell the sergeant to get it from store and no charge is made to anybody. That is the kind of business-type operation we are trying to install in the Department. We think we are making real progress along that line.

The CHAIRMAN. Is there anything that Congress can do to help you?

Mr. McNEIL. I think you have done a great deal to help us by giving us authority to carry this material under stock funds. In fact, the Army has gone a long way. They did not enter into this type of merchandising and carrying of inventory until 1953 so, they are new at the business of maintaining money controls on inventory. Practically all this improvement is of recent years. For 100 years the Army did not carry their property on a balance sheet. They do now. In the case of the Navy, they have had a revolving fund for consumption-type material since 1893 in a very small way. It has worked through peace and war very successfully. The Air Force has not gone as far as the Navy and Army.

The CHAIRMAN. Is the Air Force still maintaining separate hospitals?

Mr. McNEIL. Yes; and so is the Army and the Navy.

The CHAIRMAN. Isn't that a great waste?

Mr. McNEIL. You can spend a lot of time arguing that subject. I think the main thing is to have good utilization of the skills and talents of the medical personnel and good bed occupancy rates, and not be moving people 1,000 miles to a hospital when you could move them only 50 miles.

The CHAIRMAN. Isn't it true that largely happens?

Mr. McNEIL. Yes. There are some cases where people are moved to their own service hospital when they could have gone to a closer one. However, there has been a considerable improvement in the last few years in bed occupancy and the utilization of the skills and talents at local stations.

The CHAIRMAN. Why should not the hospital services be under the Department of Defense, and then if you wish to keep separate treatment for the various services, you could have wards or subdivisions of wards under the separate medical services?

Mr. McNEIL. You possibly could. One would think at first glance that the medical field would be one of the easiest to unify because the degree of standardization there is already very high. I do urge that this group recognize the fact that when you put things together, it does not always save us a lot of money. I think the main thing is, Are we using the assets that we have well? In hospitals, for example, do we have good bed occupancy? If we have, we probably have made 90 percent of the possible economies that might be achieved by unification. Putting things together does not always save us money. We put the clothing things together in a single manager for clothing. I have not found any real saving yet. Maybe we will make some, and I certainly hope so. The single manager for medical supplies is working out pretty well, but I don't know that we are saving money yet. I wish I could find it.

The CHAIRMAN. Isn't the chief difficulty the fact that each service wants to have hospitals and medical services under its own control? This perhaps is proper in the field. I think it is proper in the field. But in the base hospitals I see no reason for it.

Mr. McNEIL. I think that point is worth pursuing. I don't know that we would make a lot of money on it. Frankly it is being brought up constantly. The Hoover Commission brought it up.

The CHAIRMAN. We intend to continue bringing it up, Mr. McNeil, until good reason is developed why it should not be carried into effect. Every time you appear before us, some of us are going to raise this issue.

Mr. McNEIL. Mr. Chairman, resuming my statement: Direct obligations are planned at about $42.7 billion for 1960, about $1.5 billion greater than the amount requested from the Congress. I want to emphasize that one of the reasons it is greater is that the unused fiscal resources remaining after a contract has been washed out can be used as part of the financing for a new program because Congress has authorized us to have continuing type appropriations. Also, if material is sold to a foreign country for cash or to the military assistance program, the proceeds go to the credit of the appropriation concerned. So our annual program runs somewhat higher than the amount shown in the budget or the new appropriation requests from Congress.

Total defense expenditures, which have been increasing steadily year by year from the post-Korean low point of $35.5 billion in fiscal year 1955, will level out in 1959 and 1960 at about $41 billion—$5.5 billion higher than in 1955. The annual figures obscure some of the important changes which have taken place during the last 12 months. Defense expenditures declined from about $10.2 billion in the April–June quarter of 1957 to $9.4 billion in the January–March quarter of 1959. Since then the quarterly rate of expenditures has risen to an average rate of $10.3 billion in the last half of calendar 1958. We would expect total expenditures to remain fairly stable during the next six quarters, with the April–June quarter, as usual, running higher than average and July–September quarter running lower. Thus, in terms of overall expenditures the defense program should be a sustaining factor in the economic situation during 1959. You may recall that last year we indicated that the defense program would be a positive element in the economic outlook for 1958, primarily because of the unusually high volume of business to be placed during the first half of that year.

As I pointed out in my appearance before this committee last year, the trend of expenditures alone does not give the full picture of the impact of the defense program on the economy. Also important is the rate of defense obligations and their purpose, that is, procurement, research and development, and construction—the categories which most directly affect the civilian economy—and for military personnel and operation and maintenance.

Military personnel costs in 1960 are estimated at about $12 billion. Over $10.6 billion of this amount will support an active duty personnel strength of 2,520,000 men. The average cost per military man on active duty will be about $70 higher in 1960, reflecting increases in the Government's social security contributions, additional longevity pay and the further expansion of the proficiency pay program. However, we are continuing the same rates of proficiency pay, but are adding another step.

Reserve personnel costs are estimated at about $600 million, mostly for pay and allowances.

Pay of retired military personnel will amount to about $715 million in fiscal year 1960, just about double the expenditure for this purpose in 1953. I might add that these will increase even faster after 1962 when the World War II input becomes eligible. This is an increasing burden on the defense budget, but it is another built-in economic stabilizer.

Defense Department purchases of about $1.4 billion worth of food, about $200 million worth of clothing and textiles, and about $800 million of transportation for military personnel and their families in fiscal year 1960 can be attributed directly to this category of military personnel.

Operations and maintenance costs will take about $10.5 billion in fiscal year 1960, about $200 million more than in the current fiscal year. Included in this figure is $4.4 billion of the $5.5 billion payroll for the 1,080,000 civilian employees of the Department of Defense. (NOTE.—The balance of the civilian employees are paid from other appropriations, particularly those for "Research, development, test and evaluation," "Shipbuilding," and "Military construction.") Another $3.3 billion is to pay for contractual services, of which about $700 million is for transportation of things and temporary duty travel of personnel. The remaining $2.8 billion is for the procurement of consumption-type supplies and equipment, including over $900 million for petroleum products.

The CHAIRMAN. Congressman Widnall has a question.

Representative WIDNALL. Mr. McNeil, to go back to the top of the page, does that paragraph refer to retired personnel?

Mr. MCNEIL. You mean on the clothing, food?

Representative WIDNALL. $800 million for transportation.

Mr. MCNEIL. No; that is for active duty military personnel. I first started with the $12 billion going for total military personnel costs, of which $10.6 billion is for active duty personnel; reserve personnel, $600 million; and retired personnel, $715 million. Of the total $12 billion, and this is practically all for active duty personnel, $1.4 billion goes for food, $200 million for clothing and textiles, and $800 million for transportation.

Representative WIDNALL. I was confused because you said it was directed to this category of military personnel.

Mr. MCNEIL. I can see how it would be confusing. It has nothing to do with the transportation of retired personnel.

I might say, Mr. Chairman, that a good bit of this $2.8 billion of operations and maintenance funds for consumption-type supplies actually buys material from our revolving funds, who are the agencies that buy it from the public.

The volume of military construction contracts to be placed is estimated at about $1.6 billion for 1960, $400 million less than in 1959. This apparent drop in 1960 is due mostly to the carryover into 1959 of obligations originally planned for 1958. You may recall that obligations for this purpose in the first half of fiscal year 1958 (July–December 1957) amounted to only about one-quarter billion dollars. While $1.3 billion was obligated for this purpose in the second half of the fiscal year (January–June 1958) the total for the year amounted to only about $1.6 billion, leaving several hundred million dollars to be obligated in fiscal year 1959.

Representative WIDNALL. I would like to ask another question at that point: Has the Defense Department ever broken down the figures as to the additional cost in military construction for the duplication of engineering effort? I believe in the housing of personnel there is a 3 percent factor that goes to pay the regularly employed military personnel who are engineers in the field, and you actually have a payment that you are making in connection with every contract with outsiders working on the project. You have two sets of people working on it, whereas in normal private construction you only have one.

Mr. McNEIL. I think that is worth looking into again. We were concerned 2, 3, or 4 years ago with the rather high rate of overhead of the engineers which included this preliminary engineering, drawings, and so forth. At the time we thought we had done pretty well in eliminating what appeared to be duplication. In housing, the engineering work would be of the preliminary type necessary to get initial plans, to find out what was wanted, to facilitate presentation to Congress, and so forth. After the program was developed, you engaged your private architect and engineer to develop your detailed plans. But there is no real duplication in that work; I would not say there is not some of it elsewhere in the operation.

Representative WIDNALL. I have constantly heard criticism with respect to overspecification of military housing and it becomes much more expensive than it should be. For instance, the foundation work on a house; it has to be built different than normal housing.

Mr. McNEIL. I have heard the same word.

Representative WIDNALL. Actually we could perform a real service in saving money in that respect.

Mr. McNEIL. I am glad you brought it up. I would have used the same words. Your comments will prompt me to look into it once more. Thank you.

Obligations for construction are normally much lower in the July–December period than in the January–June period. Thus about $630 million was obligated in the June–December 1958 period, and leaving about $1.3 billion to be obligated in the January–June 1959 period. Obligations for construction during fiscal year 1960 may be expected to follow the same general pattern, with about $600 million to $700 million being placed during July–December 1959 and about $900 million to $1 billion being placed in the January–June 1960 period.

The CHAIRMAN. You will forgive me if I interrupt again. I have been reading in advance, and it seems to me the rest of your statement is factual. Unless there are specific points that you would like to emphasize, I wonder if it would be satisfactory if we have the remainder of your statement printed in the record, because there are certain questions that I wish to direct to you on the question of contracts.

Mr. McNeil. I can sum up in just a couple of sentences the important points that remain.

With regard to employment in defense related industries, we find that while our expenditures in those industries are continuing at a rather stable rate, or even an increasing rate, employment levels probably will not go back, in the next few months at least, to the 1957 levels.

One other point is that because of the rather level programs of 1959 and 1960, and the fact that we are making every effort to avoid peaks and valleys—in other words, keep the flow of business at a rather stable level throughout the year—we feel that the business of defense can have a sustaining or stabilizing effect on the economy through the next 18 months.

(The unread portion of Mr. McNeil's prepared statement follows:)

You may recall that in the summer and fall of 1957 obligations for procurement and research and development were at a very low rate, amounting only to $6.8 billion in the July–December 1957 period although the total planned for the year was normal. There was some skepticism expressed here last year as to our ability to complete the high rate of planned obligations during the last half of fiscal year 1958. Actually, a total of $11.9 billion was obligated for procurement and research and development in that 6-month period—somewhat higher than originally planned.

The rate of obligations during the July–December 1958 period was higher than the comparable 1957 period, totaling $8.8 billion, over 43 percent of the annual program, leaving a total of about $11.6 billion to be completed during the January–June 1959 period.

If we assume that roughly the same pattern will prevail during fiscal year 1960 we can expect obligations for procurement and research and development to amount to about $8.6 billion during the July–December 1959 period, and about $10.5 billion in the January–June 1960 period, bringing the total for fiscal year 1960 to $19.1 billion.

The obligations figures for procurement and research and development which I have just been using are of necessity on a gross basis, since this is the only basis upon which the services can report these figures monthly or quarterly. Adjustment of the $19.1 billion figure, for example, to eliminate certain intradepartmental transactions would result in net or direct obligations of $18.6 billion for 1960, as shown in the budget document. To either the gross or direct obligation figure for fiscal year 1960 would have to be added an estimated $800 million of additional obligational availability expected to accrue from fiscal year 1960 military assistance program orders in order to make the 1960 figures comparable with those of prior years.

Last year I mentioned the rapid changes in the product mix of our major procurement and the serious impact of these changes on individual industries and firms as well as their employees and the communities in which they are located. These changes will continue into fiscal year 1960. The percentage of the procurement dollar devoted to aircraft will continue to decline in 1960 while the percentage going to missiles continues to increase. Whereas aircraft took 58½ cents of every procurement dollar spent in fiscal year 1957, they will take only 45 cents in fiscal year 1960. Conversely, missiles took a little over 15 cents of the procurement dollar in 1957 and will take about 27 cents in 1960. The proportion of the procurement dollar going for ships will increase from about 6½ cents in 1957 to over 11 cents in 1960, and electronics and communications equipment will go up from 6½ cents to over 7 cents. The proportion of the procurement dollar going for ammunition and for production equipment and facilities will continue to decline.

As I pointed out last year, the impact of defense expenditures on employment in specific defense-related industries cannot be measured with any degree of precision but it is possible to trace some rough relationships by relating Defense Department budget categories to Bureau of Labor Statistics employment categories. At best, it is only a rough-and-ready comparison.

The industry perhaps most directly related to the defense program is the aircraft and parts industry. Here employment dropped from a peak of about 890,000 in the spring of 1957 to about 740,000 in the spring of 1958. During the last few months of 1958 employment in the aircraft and parts industry has averaged about 765,000, about 115,000 or 13 percent less than the previous peak, but only 35,000 or about 4 percent less than the peak employment resulting from the Korean war.

While average employment in this industry during fiscal year 1958 was considerably less than in fiscal year 1957, defense expenditures for aircraft and missiles were considerably higher. Part of the explanation for this divergence lies in the fact that each defense dollar spent in the aircraft and parts industry supports less employment year by year as average weekly earnings continue to rise. There was a rise of 10 percent, for example, from the second quarter of calendar year 1957 to the final quarter of 1958.

Another important factor, no doubt, is the increasing proportion of engineering personnel employed in the industry. These people are paid at a higher rate than production workers.

A third factor is the increase in the research and development, and procurement of missiles. Although the aircraft companies have received the bulk of the missile contracts, the proportion of outside work on these weapons, particularly electronics, is much greater than on aircraft. Since defense expenditures for aircraft and missiles are expected to remain fairly stable through fiscal year 1960, there will probably be little change in the employment level in the aircraft and parts industry.

The relationship of employment in the shipbuilding industry to defense expenditures for shipbuilding is not as direct as in aircraft. But there has been a continued uptrend in defense expenditures for this purpose during the last few years, and employment has shown a substantial recovery during the last quarter of 1958 and is almost back to the 1957 level.

Communications equipment is another industry closely related to defense. Here, too, expenditures have been going up and employment has already recovered most of the loss suffered since the second quarter of 1957. The proportion of the procurement dollar going for electronics, including the electronics equipment incorporated in the complete aircraft, missiles, and ships, will probably continue to increase for some time to come.

There remains to be discussed the relationship between defense expenditures and obligations for military hard goods on the one hand and sales, new orders, unfilled orders, and inventories of the durable goods industry on the other hand. It is interesting to note that although sales of durable goods industries dropped sharply from the April-June quarter of 1957 to the January-March quarter of 1958, defense expenditures during this period remained remarkably steady. This is in marked contrast to the popular misconception that the sharp decline in durable goods sales was triggered by a sharp drop in defense expenditures.

The relationship between defense obligations for hard goods and new orders received by the durable goods industry, however, is quite evident. As we indicated last year, the unusually low level of defense order placements in the summer and fall of 1957 undoubtedly contributed to the drop in activity in the durable goods industry at that time. However, we also pointed out last year that the unusually high level of defense contract placements in the first half of 1958 would be a positive element in the economic picture.

In conclusion, planned employment by the Department of Defense, both military and civilian, is expected to remain relatively constant during fiscal year 1960. The overall procurement level of both hard and soft goods will continue at about the level of 1959. Every effort is being made in our planning to avoid sharp fluctuations in the rate of contract placement during the balance of this year and in 1960. For these reasons we think that the defense program as a whole will continue to be a stabilizing factor in the economic picture during this period.

The CHAIRMAN. Mr. McNeil, I think it was 2 or 3 years ago that Congressman Hébert made a report which showed that of the contracts granted by the Department of Defense, some 95 percent were negotiated contracts, and only 5 percent were subject to competitive bidding. There was quite a debate on the floor of the House on this matter and there was quite a debate on the floor of the Senate in which the Senator from Ohio and I participated, and we waited with great curiosity and interest to see whether or not there would be some improvement on the part of the Department of Defense.

The Secretary of Defense issued a report on military prime contract awards for the year July 1957–June 1958, and on page 26 of that report he showed that of the 5,100,000 contracts awarded by the Department of Defense during the fiscal year, only 275,000 resulted from formally advertised bids. Therefore, only 5 percent were subject to competitive bidding, and again 95 percent were negotiated.

In terms of dollar volume of the $23.7 billion, within the continental limits of the United States, only $3.3 billion came from advertised bids, or competitive bidding, $20.4 billion from negotiated bids, or percentagewise 14 percent from competitive bidding and 86 percent from negotiated bids.

We know, of course, in the case of secret weapons those have to be negotiated because you cannot publish the details to the world, although I am told that Admiral Rickover built the *Nautilus*, which was certainly a classified submarine, under competitive bidding. I think that is correct.

Mr. McNeil. I don't believe that it was all advertised. The *Nautilus* contract had elements of competition in it to the extent of getting the three or four firms in the field around the table.

The Chairman. They were not negotiated.

Mr. McNeil. It was really competitive negotiation, if you want to call it that. I think it was a mixture of both.

The Chairman. We also know the great evils which can come from negotiating contracts where a supply officer or procurement officer will deal only with one person and where supervision is difficult. All these reports which I have here are examples of abuses which the Comptroller General has found. I will give the titles for the record.

"Examination of Subcontracts with Firestone Tire & Rubber Co."

"Examination of Department of Navy Negotiated Contracts With Collins Radio Co. of Cedar Rapids, Iowa."

"Examination of Subcontracts Awarded to Goodyear Aircraft Corp., Arizona Division."

"Examination of Army Contracts and Subcontracts With the Birdsboro Armorcast Co., Birdsboro, Pa."

"Examination of Subcontracts Awarded to Lambert Engineering Co., St. Louis, Mo."

Senator O'Mahoney. Mr. Chairman, may I interrupt to suggest that at the same time, if it is available, you read the name of the prime contractor?

Mr. McNeil. Were these supposed to be contracts which he thought should be competitive bidding or advertised bidding instead of negotiated?

The Chairman. Mr. Campbell gave these as examples of where the prices were negotiated rather than subject to competitive bidding. I think in virtually every instance he raised serious questions about the procedure. He referred to undesirable practices.

Mr. McNeil. Are they prime contracts of the Department or were these subcontracts?

The Chairman. They are in both categories. The one I have before me reads:

Subcontracts with firm fixed price purchase orders awarded by administrators of various prime contractors under negotiated prime contracts of the Department of Air Force and Department of Navy.

Prices proposed for the subcontracts were generally accepted by the prime contractors without price or cost analysis or comparison with subcontractors' cost experience.

The ones I have read are generally prime contracts. I will say in the case of Collins Radio it seems to be a prime contract. Here is one, "Examination of the Pricing of the Department of Air Force Contract With General Motors Corp. A–C Spark Plug Division," which seems to be a prime contract.

"Examination of the Department of Navy Contract Negotiated With the McDonnell Aircraft Corp. of St. Louis." I will read a paragraph there:

Establishment of firm price for airframe to be produced by contract by Navy contracting officials utilized without adequate verification of cost data which included duplicate cost and costs not applicable to airframes, of $6 million less than the amount contract, of which $2,969,000 could have been recognized by Navy contracting officials by an accurate review of costs data available at the time the price was established.

"Examination of the Pricing of the Department of Air Force Contract With General Motors." That seems to be a duplicate.

"Examination of the Pricing of Department of Air Force Contracts and Subcontracts With Avtron Manufacturing Co. of Cleveland." The finding of the Comptroller General was that the report discloses that unnecessary costs were incurred to the Government because of the fixed-price contracts and subcontracts that were awarded without adequate verification of the cost analysis.

Here is a contract of the Army with the A. O. Smith Corp. of Milwaukee. The report discloses that agency officials negotiated prices without verifying cost data which the contractor furnished in support of his total price. Another is "Examination of Subcontractor, Chrysler Corp., Under Department of Army Contracts." I have not exhausted the list. There are certain others which I will merely cite for the record.

(The information referred to follows:)

"Department of the Navy Contracts With Cleveland Diesel Engine Division of General Motors."

"The Practice of Insuring Government-Owned Facilities, Chance Vought Aircraft, Dallas, Tex."

"Contract With Curtiss-Wright Europa, N.V."

The Chairman. These are simply samples.

Mr. McNeil. I still do not get the point here exactly. I was going to make a suggestion, if I may, sir, that we could take the list, and have representatives appear after taking a look at these reports and respond directly to them. We would be very happy to do so.

The Chairman. Here is one made in March 1958. Here is one February 1958, March 1958.

Mr. McNeil. I would like to inject at this point, if I may——

The Chairman. I want to make two points clear. First, more contracts should be let by competitive bids. Second, that better methods are needed in negotiation. I can say in any city where 86 percent of its dollar volume in U.S. contracts is awarded by negotiation of contracts, every reporter in the city would be on the neck of the mayor.

Mr. McNeil. I think, Mr. Chairman, we could probably narrow this down a little bit. The 95 percent would only apply to weapons sysems, because all our consumption goods which runs into several billion dollars a year, is generally competitive bidding. On the major weapons systems it is not.

The Chairman. Is the Secretary incorrect in the figures? The report states that it includes prime contracts to obtain military supplies, services, or construction.

Mr. McNeil. We are dealing, I think, with weapons systems and not procurement of food, gasoline, and all the other different types of consumption material across the board, because that is generally all competitive bidding. It is not negotiated.

The Chairman. What about signal equipment?

Mr. McNeil. Some of it is competitive and some of it is negotiated. Some of the newer equipment is on a cost-plus-fixed-fee basis.

The Chairman. Medical supplies.

Mr. McNeil. Practically all that is competitive bidding. Clothing is competitive bidding. There could be some items that are negotiated but most of it is procured by competitive bidding. Food except for perishibles is always competitive bidding.

The Chairman. What about trucks?

Mr. McNeil. 100 percent competitive for standard types.

The Chairman. Earthmoving machinery?

Mr. McNeil. That is competitive, although there could be some particular items that some time has been negotiated. For example, some particular heavy-duty earthmoving equipment that is not a standard commercial item.

The Chairman. I think we saved the Department of Defense over a million dollars by calling to your attention a negotiated contract.

Mr. McNeil. On earthmoving equipment?

The Chairman. My impression is that we found an overcharge—I personally found—of a million dollars which was corrected and the contract was put up for competitive bidding and the bids were relet. There was a saving of a million dollars.

Mr. McNeil. That is on earthmoving equipment?

The Chairman. Yes.

Mr. McNeil. I said that on earthmoving equipment, if it is of some special design, it could have been on a negotiated purchase. Anything of a standard commercial nature, such as trucks and that type of thing, and even military trucks, are all competitive bidding without exception.

The Chairman. Do you take the position, Mr. McNeil, that we should not increase the proportion of competitive bidding?

Mr. McNeil. No, I don't. I would like to see it increased to the extent that it can be. I do say we have trouble doing so in all our major weapons systems, such as Atlas, Titan, Polaris, and that type of thing. There are parts of those programs that can be made competitive and some are now. You mentioned our good friend, Admiral Rickover. Actually in our contract reports we show the *Nautilus* as a cost-plus-fixed-fee contract and not as an advertised-bid contract. Yet I know that the Bureau of Ships sat down with different people to find out which company was the best one to get the contract. But it was not a formally advertised contract. We will not report the *Nautilus* as an advertised contract.

The CHAIRMAN. They played one contractor off against another.

Mr. McNEIL. Yes. But we are reporting it differently. We report the *Nautilus* not as a formally advertised bid, but rather as a cost-plus-fixed-fee contract with Electric Boat Co. Yet Admiral Rickover did a lot of negotiating to get it done.

The CHAIRMAN. You think the percentage of competitive bid contracts should be increased?

Mr. McNEIL. I think we should constantly strive to do it that way. Otherwise, human nature will drive it the other way.

The CHAIRMAN. There is a discouraging thing. Congressman Hébert 2 or 3 years ago showed that only 5 percent of the contracts were let by competitive bidding, and the Department of Defense comes in this year and says only 5 percent. So between this study by Congressman Hébert and last year, no apparent progress was made.

Mr. McNEIL. I can't identify the 5 percent. That puzzles me a little bit.

The CHAIRMAN. There was 275,000 out of a total of 1,500,000 transactions. It is on page 26 of the report.

Mr. McNEIL. That includes purchases of gasoline, oil and things of that nature. We don't have 5 million major procurement transactions. I think we will have to get a breakdown of this for you that is much more descriptive than this table.

The CHAIRMAN. All we can work from is the table submitted by the Department of Defense.

Mr. McNEIL. I understand. It would be our fault for not making it clear. The volume of business we have placed in competitive bidding is far more than 5 percent.

The CHAIRMAN. It is 14 percent on the domestic bids.

Mr. McNEIL. On the advertised business.

The CHAIRMAN. Only $3.3 billion out of $23.7 billion.

Mr. McNEIL. That is the formally advertised.

The CHAIRMAN. There is another thing which is involved in this; namely, that the frequently close relationships which exist between the procurement officers and the supply firms. This is a great abuse in private business. We know that there are abuses in the services. There is still another factor; namely, the tendency of many high-ranking officers upon retirement to go into the service of companies which are supplying goods to the Defense Department. From having been on one side of the desk at one period of time, they move to the other side of the desk in rather a brief time. When this is accompanied by negotiated contracts, not subject to the competition of competitive bidding, there are possibilities of great abuse.

Mr. McNEIL. I agree there are possibilities. There have been a number of investigations of things of that kind for a number of years by the Comptroller General and by our own audit groups. I think the record is pretty clean. I agree that there is always the temptation and it could happen. Yet we have a very great many of these competent people leaving the military services, and somebody will hire them and some of them have real talents to supply to some of these companies. I think it is a question of national policy, perhaps, but I don't know how we can prevent them from accepting remunerative employment in fields where they are competent. I think you have to be very careful to maintain a very high standard of ethics as far as collusion, influence, and things of that kind are concerned.

The CHAIRMAN. Certainly it does indicate that if possible the contracts should be let through competitive bidding.

Mr. MCNEIL. I agree, sir. On the weapons system contracts, however, they are not really susceptible to that kind of treatment.

The CHAIRMAN. May I raise a few other points while Senator O'Mahoney is getting some material.

Does it seem likely that the defense expenditures will be held within the President's budget terms? Are they now running at the budget rate or in excess?

Mr. MCNEIL. They are running a little over the budget estimate. They are shown in the Federal budget for this year at $40.8 billion. I am sure it will be at least that figure. They could be as high as $41 billion. I think that something in that range will cover it.

The CHAIRMAN. How sharply do you expect defense spending to rise in the years ahead, looking at the long view?

Mr. MCNEIL. That is a crystal ball question, because it is affected by so many things. I would say that if conditions stayed about the same as far as the world situation is concerned, expenditures might rise a little, but not too much, in the next 2 or 3 years.

The CHAIRMAN. In other words, do you foresee a sort of leveling off of defense outlays barring sudden emergencies?

Mr. MCNEIL. Generally, but perhaps in the balance it could be a little on the upside.

The CHAIRMAN. Because of increased costs?

Mr. MCNEIL. Perhaps because of increased costs.

The CHAIRMAN. Senator O'Mahoney.

Senator O'MAHONEY. Thank you, Mr. Chairman. I was asking my office to send up a copy of the report by Mr. Campbell. That is, his annual report. No doubt you are aware, Mr. McNeil, that for some years now Mr. Campbell has been criticizing military expenditures abroad. He charged, for example, that arms were sent to some nations which could not use them because they did not have military forces in number or in knowledge sufficient or equal to the use of these weapons. While weapons purchased by us and transported abroad to one nation were lying unused within the boundaries of that nation, similar requests would come from other nations and duplicate arms would be sent out. I notice in the President's budget that there is the estimate for military expenditures for mutual security is less. It may be that is a result of the criticism of the Comptroller General. When the volume is received, I will suggest several pages to you, not for answering now, but for answer at your leisure after going over them. I do suppose, however, that there has been some cutback because of the charges of overexpenditure under mutual security programs.

Mr. MCNEIL. Senator O'Mahoney, I think that we need Government studies, investigations, audits, whatever you choose to call them, by people like the Comptroller General or by agencies of the Congress. We have to have them and we should expect it. May I say this on these investigations with respect to the allocation or shipment of military equipment to other nations. There has been probably 17 or 18 billion dollars worth of material shipped since 1949 to the various countries in the military assistance program. There have been some mistakes without a question. I know one case that Mr. Campbell mentioned in the Middle East where certain material was not used. It got there before it was needed. In fact, there was some material that could not be used for 2 or 3 years. It was an error, I think, on the whole. However, if you take the military assistance program as a whole you will find that a very high percentage of it was well done. Maybe 5 percent was wrong. Sometimes, of course, for political or other reasons the material was shipped to encourage other countries to develop forces which later they did not develop.

Senator O'MAHONEY. When you say political reasons, what do you mean?

Mr. McNEIL. International political reasons. I don't mean domestic politics.

Senator MAHONEY. I understand.

Mr. McNEIL. For example, it may be considered desirable to encourage a certain country to join with the free world and carry its share of the load. You have a chicken and egg proposition. You can develop the forces, and after they get the forces on the parade ground, then ship the material, or you can ship the material in line with plans to develop the forces.

Mr. O'MAHONEY. Here is another criticism that Mr. Campbell made.

Mr. McNEIL. May I finish this one thing?

Senator O'MAHONEY. Certainly.

Mr. McNEIL. I know one country in Europe that we think is one of our very good allies. We shipped aircraft to them because, according to the plan, they were going to have pilots ready to fly them. In their own budget they indicated that they had the money to fly the airplanes. They did not fly them the following year. Investigation showed we should not have sent the planes when we did. Yet, if the airplanes had not been there, that country would not have made the contribution to tactical air power in Europe that it did eventually. You are dealing with all kinds of plans formulated by different governments, and sometimes they just do not dovetail.

Senator O'MAHONEY. I did not want to pursue the matter in generalities because this is an unproductive exchange. I wanted to pursue the matter on the basis of the Comptroller General's report to the Congress. I have had that report thoroughly read by one of the members of the staff. I would like to submit it to the Department of Defense to secure an answer from them, a considered answer, to file it for this record. (See p. 686.) I think it is important for Congress to know what reaction has taken place in the Department to these suggestions from the Comptroller General. The mere fact that I recite that the Comptroller General made the criticism does not mean that I know the criticism is just. I am not seeking to take advantage of the Department of Defense. I know from long experience that war and preparation for war is carried on with golden shovels, and there are a lot of expenditures that could be cut down.

For example, take the long fight we have had over the desire to enforce in the Department of Defense a rule of consolidated buying for common-use items. What progress has been made on that?

Mr. McNeil. Just before you came in I pointed out that in four major areas it has been pretty completely done. These areas are food, clothing, medical supplies, and petroleum.

Senator O'Mahoney. You have already gone over that for the record?

Mr. McNeil. Yes.

Senator O'Mahoney. Then I don't want to pursue it.

Mr. McNeil. In other areas there is a great deal of joint purchasing by the services, but it is not formally set up by Department of Defense as a departmentwide affair. For example, the Army is buying certain equipment for the Navy, and vice versa. There is a great deal of that, as you know, in the single service procurement.

Senator O'Mahoney. Would you estimate the saving that is being made in this budget for 1960 as compared with the budget for 1959 by following this policy urged so long by Congress?

Mr. McNeil. You mean on those four items?

Senator O'Mahoney. Yes, percentagewise.

Mr. McNeil. I don't see that we have much saving. I just mentioned that before you came in. We certainly have hopes and are striving for it. The only way I can find a saving is if we can do the business with less inventory and with less people. So far we have not been able to do that.

Senator O'Mahoney. Will you file a summary statement?

Mr. McNeil. I will.

(The information referred to follows:)

There appears to be a mistaken impression that large sums of money can be made available from savings effected through single-manager operations. Although some savings have been achieved through the reduction of inventories and operating expenses in the Defense Department supply system as a whole, it is difficult to assess the extent to which these savings are wholly due to the single-manager assignments in contrast to those which would have been attained through the system of individual service management.

The inventories of materiel which qualify for consideration for single-manager assignments are generally capitalized under Department of Defense stock funds. Such materiel is purchased by the stock funds in terms of net requirements, i.e., items in short supply are purchased to meet sales requirements, while items in long supply are sold to consumers without replacement. This policy is implemented through the budgetary review channel, whether the items are separately managed or by the military services, or are managed under single-manager assignments. The fiscal year 1960 budget—for the stock funds as a whole and for the single-manager areas—demonstrates the progress expected in reducing inventories of materiel and reducing investments in inventories. Reductions in inventories carry concomitant reductions in personnel costs for supply management, storage and maintenance of materiel. These reductions, to the extent that they can be identified, are reflected in the fiscal year 1960 budget.

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Progress planned in the fiscal year 1960 budget for stock funded materiel and the proportion of this materiel under current single-manager assignments is shown below:

[Dollars in millions]

| | Total stock funds | Single-manager assignments | Percent single-manager assignments |
|---|---|---|---|
| Sales, fiscal year 1960 | $5,145 | $3,870.9 | 75.2 |
| Obligations, fiscal year 1960 | $4,883.4 | $3,772.1 | 77.2 |
| Amount of sales program not requiring reinvestment in inventory | $261.6 | $98.8 | 37.8 |
| Percent of sales program not requiring reinvestment | 5.1 | 2.6 | |
| Inventories: | | | |
| June 30, 1959 | $8,139.9 | $3,306.7 | 40.6 |
| June 30, 1960 | $7,242.2 | $3,071.8 | 42.4 |
| Amount of reduction during fiscal year 1960 | $897.7 | $234.9 | 26.2 |
| Percent of reduction during fiscal year 1960 | 11 | 7.1 | |

As may be noted above, significant progress is being made in reducing inventories carried in stock funds through the enforcement of regular supply and financial policies whether or not such inventories are under single managers.

Perhaps the most promising potential economies associated with the single-manager concept arises from opportunities it provides for eliminating concurrent buying and selling and for diminishing backhauls and crosshauls through integrated distribution operations. Although they are not precisely measurable it is reasonable to conclude that some economies from these sources have been achieved. Although they may have been partially offset during the initial phases of the single-manager operation by expenses related to adjustment to new distribution patterns, once adjustments to desired distribution patterns have been completed, economies should be possible on a continuing basis.

Senator O'MAHONEY. In response to Senator Douglas' queries about negotiating bids and the like, have you personally followed the negotiation of bids?

Mr. McNEIL. No. Generally, yes, but not intimately.

Senator O'MAHONEY. Have you followed renegotiations?

Mr. McNEIL. Only generally; not directly.

Senator O'MAHONEY. Where can we get a report of the renegotiated bids?

Mr. McNEIL. You mean on the price redetermination or renegotiation afterwards?

Senator O'MAHONEY. What has been returned to the Government by way of renegotiation?

Mr. McNEIL. Not too much.

Senator O'MAHONEY. There were some releases from the Department of Defense the other day that General Motors returned some $9 million plus to the Department of Defense because of overcharges that were renegotiated. Do you know anything about that?

Mr. McNEIL. Yes. I know a bit about that one. That was the result of a dispute which was never settled, and General Motors finally returned the money although there had never been an agreement on the settlement. I am told by people in Detroit that they did it partly as a public relations matter because the discussion had been carried on for 2 or 3 years.

Senator O'MAHONEY. That was an illustration. I know nothing about the facts except what I saw in the paper. There probably are other renegotiations. So you will see that we get a statement showing the amount of money that has been recaptured by the Government by reason of renegotiation, and the sum that has been repaid, let us say, during the last fiscal year?

Mr. McNEIL. There are two parts, just so I get it clear. Renegotiation, as such, is undertaken by the Renegotiation Board, which does not report to the Secretary of Defense. But we can get that information and file it for you.

(The following was subsequently received for the record:)

THE RENEGOTIATION BOARD

REFUND DETERMINATIONS

During the fiscal year ended June 30, 1958, the Renegotiation Board made 254 determinations of excessive profits. This brought to 3,202 the total number of such determinations made by the Board since its inception. Of the 254 determinations made during fiscal 1958, 202 resulted in bilateral agreements between the Board and the contractors involved; the other 52 resulted in the issuance of unilateral orders for refund payments. The excessive profits represented by all 254 determinations were $112,724,199; those covered by the agreements were $61,042,216. The following table shows that the cumulative total of all Board determinations of excessive profits through June 30, 1958, was $723,055,054. This amount, and the figure for fiscal 1958, are broken down in the table according to the renegotiable sales volumes represented in the determinations.

*Analysis of refund determinations with respect to renegotiable sales volume to June 30, 1958*

| Renegotiable sales volume | Refunds determined [1] | Portion of total |
|---|---|---|
| | | *Percent* |
| Fiscal year ended June 30, 1958: | | |
| Under $500,000 | $684, 164 | 0.6 |
| $500,000 to $1,000,000 | 2, 871, 277 | 2.5 |
| Over $1,000,000 | 109, 168, 758 | 96.9 |
| Total for the year | 112, 724, 199 | 100.0 |
| Cumulative to June 30, 1958: | | |
| Under $500,000 | 24, 652, 379 | 3.4 |
| $500,000 to $1,000,000 | 42, 351, 593 | 5.9 |
| Over $1,000,000 | 656, 051, 082 | 90.7 |
| Total to June 30, 1958 | 723, 055, 054 | 100.0 |

[1] By agreements or orders.

Source: The Third Annual Report of the Renegotiation Board.

Mr. McNEIL. Then we have within the Department the work of the contracting officers in price redetermination before contracts are completed. That has to do with adjustment of the final contract price based upon the cost experience of the manufacturer. It may be a bit difficult to get this information but we will see what we can get on refunds and recoveries after contracts have been completed.

Senator O'MAHONEY. I noticed that you opened your statement, Mr. McNeil, by saying that you were here as a representative of the Department to contribute what you can to the consideration of the President's Economic Report. You point out that the Secretary of the Treasury, the Director of the Budget, the Council of Economic

Advisers, and other Government officials who dealt with the Federal budget and the economy as a whole have already testified before this committee, which is true. You say that the defense budget, and I am quoting your statement now:

> The 1960 defense budget is based on the premise that the Nation's essential military requirements must be met.

Would it be proper for me to ask you, do you in your own opinion believe that these essential military requirements have been met in the budget?

Mr. McNeil. Yes, I do. I have listened to these discussions for a good many years. As you know, when you were chairman of the Senate Appropriations Subcommittee, I was listening to them then. I believe that those people, in whose judgment I have a great deal of confidence, would all agree that this budget does accomplish these purposes.

Senator O'Mahoney. I know as a result of those sessions that we used to have in the old days that there was some pretty wide disagreement among the leaders of the Department of Defense in what would be essential for military defense.

Mr. McNeil. That is right, sir.

Senator O'Mahoney. Finally, what was presented to Congress was a compromise among the departments.

Mr. McNeil. There are still differences. I mentioned that in the statement.

Senator O'Mahoney. And still compromise.

Mr. McNeil. Yes, although I believe they are much closer today than they were 5 years ago or 8 years ago.

Senator O'Mahoney. But all disagreement has not been eliminated yet.

Mr. McNeil. No, and it probably never will be.

Senator O'Mahoney. Can it be said to the public and to the Congress—can this committee report to the Congress—that the defense budget is a budget which cannot be cut or expanded in the Nation's interest?

Mr. McNeil. There never has been a budget prepared that could not have some dollars taken out.

Senator O'Mahoney. Yes, I agree with that generality, Mr. McNeil, but this is what I am thinking of. Personally, I believe that freedom in the world as we have grown to know it and love it stands in great danger. I believe that the Soviet Government, having made a driving expansion of its military production, its scientific production, its development of missiles and satellites, feels that it is in a position where no war against it can be successful, and where it is unnecessary for Soviet Russia to wage a shooting war against us. Nevertheless, it seems to me from what the Russian statesmen have said, to be quite clear—the Russian leaders, perhaps I should say, rather than statesmen, the latter being a proper cognomen for them—what they have said seems to be based upon complete faith that they are ahead of us in military, missile, and satellite production. I judge that in the Department of Defense there are many military leaders in every branch of the service who entertain the same opinion. I feel that because of this conviction by the Russians they have turned to the cold war against the United States. They want to destroy our power to produce, if they can do it. We get reports from leaders of business, too, and many of these indicate that the Soviet campaign is designed to break the world market price in many commodities. You have heard those reports.

Mr. McNeil. Yes, sir.

Senator O'Mahoney. Do you think that in preparing for the next fiscal year we have done enough with respect to the defense budget and the domestic civilian budget to make certain that the income of the United States will continue to rise to enable us to make the expenditures which defense leaders believe are necessary, or are we to draw the conclusion, as some witnesses have drawn, that the budget for 1960 was based primarily upon the desire to balance the budget and to stabilize prices?

Mr. McNeil. You asked a number of questions.

Senator O'Mahoney. Yes, I know that.

Mr. McNeil. There is no question that any military budget that I have been connected with over the years has been limited, set in a ball park way at least, by actual revenues or potential revenues, debt limits, and so forth. There is no question but that Federal income has had something to do with budgets. To the extent that they would put pressure on us to take out things that were unnecessary there would be no harm done, and I think everybody would applaud it. Only if such pressures made you cut out things that were considered quite essential would it seem to me to be getting us into difficulty.

I would like to ask if I may to stick to the defense portion, because I think you have had some very competent witnesses on the economy as a whole—that is, whether the Government's economic policy is generally correct.

Senator O'Mahoney. The only reason I asked the question, Mr. McNeil, because while you have come here to speak for the Department of Defense, it must be common knowledge that what we can do by way of defense depends entirely upon what we can do on the production of tax revenue that will in fact balance the budget. I am advised that the Department of Labor is today reporting that unemployment for January was not less than it had been thought to be, but more.

Senator Douglas. Will the Senator yield?

Senator O'Mahoney. Certainly.

The Chairman. Since it is now 2 minutes past 12 o'clock, and since figures for unemployment for January were released precisely at 12 downtown, I wonder if the Senator would forgive me if I put them in the record?

Senator O'Mahoney. Of course, let us put them in. I heard them last night.

The Chairman. There is a labor force of 67,430,000, estimated total employment of 62,706,000, unemployment of 4,724,000, contrasted to unemployment figure of 4,108,000 in December. It is true that there is generally a seasonal rise between December and January. On unadjusted rates the percentage of unemployment for January, 7.0; seasonally adjusted, 6.0; as compared to a figure of 5.8 seasonally adjusted last January.

There is another factor which I have tried to get included in the official figures for several years unsuccessfully, namely, the full-time equivalent of the voluntary part-time unemployed, namely, how much unemployment exists within employment. That would amount according to our computation—these are not figures from the Department of Labor or Department of Commerce although they are based on their figures—to 1,080,000 more, or according to our figures again a sum total of completely unemployed and the equivalent of the involuntary part-time employed, 5,804,000, or something over 8 percent on an unadjusted basis, and something over 7 percent on an adjusted basis.

Senator O'MAHONEY. Mr. Chairman, I am glad you put that in. That is the factual situation which has been called to my attention. We are dealing with the Full Employment Act of 1946. That law was enacted by Congress and approved by the President and observed by the present President, with the idea that one of our major programs—one of our major policies—as a nation should be to keep the economy growing. The facts which are presented to us show that the position of the Nation debtwise is getting worse than it ever was before. We are paying more interest upon the national debt than we ever began to think of paying before. This interest on the national debt has been rising steadily since 1953, from something a little over $5 billion a year to something now over $8 billion a year.

At the same time, the price of Government bonds, bills, and notes sold by the Treasury for the purpose of raising the money with which to pay the cost of defense and economic growth, are selling at less than par for the most part.

In the last several days I have noticed quotations in the market. They have shown that bonds, bills, and notes have tended downward steadily, whereas on the other side of the market, common stocks are rising, seemingly in anticipation that inflation is coming. Common stocks are the vehicle to hedge against inflation.

Therefore, it seems to me it is utterly impossible for the Department of Defense to figure its budget without considering the full national economy.

Mr. MCNEIL. I think that is correct, Senator.

Senator O'MAHONEY. I am sure the experts on your staff and those of Secretary McElroy are experts in real name.

Mr. MCNEIL. I think we have to emphasize the defense aspect, but we certainly have to pay attention and be quite aware of the effects of anything that is done. First, we certainly want as stable a price structure as we can, because in the last few years it had affected our whole budgetary operation and our planning. Looking ahead to the immediate future, the balance of 1959 and 1960, in our planning we are anticipating the most stable price structure we have had in 4 or 5 years. Just how long that will last I don't know at the moment.

Senator O'MAHONEY. May I interrupt you to say at that point that if it be a fact—and I think it is the fact—that the prices that the Department of Defense must pay for the things they must buy have been increased by inflation tremendously. There is no doubt about it. That makes me think of the questions which Senator Douglas asked you, and the statement I find in the Annual Report of the Comptroller General of the United States for 1958 on page 80, with respect to contracting. This statement confirms what Senator Douglas quoted from the annual report of the Department. Reading from page 80 under the title, "Contracting," I find this:

The volume of purchasing under contract by the military departments now amounts to about $25 billion annually, and represents about 35 percent of the total Federal budget. The complexities of so large a program are without parallel and affect almost all Government agencies and a vast number of business concerns, large and small, in the country. It has a pronounced effect upon the entire economy of our country. Government and industry alike, buyers, sellers, and taxpayers, have a vital stake in seeking the most effective policies and practices by which this tremendous procurement can be accounted for.

It has been estimated that 80 to 90 percent of all military purchases are made by negotiated contracts. Prices under negotiated contracts are established to a large extent on the basis of the contractor's actual or estimated cost of production rather than on the basis of competitive bidding. Therefore, evaluation of the reasonableness of prices requires a knowledge and thorough analysis of the various cost elements from the standpoint of the conditions and circumstances present at the time of the award. Effective negotiation requires that both government and industry have a full understanding of all pertinent factors. In our contract audit work we appraise on a test basis the agency's contracting and review of contractor's operation. The contract negotiations are of particular importance. We are concerned, among other things, with the effectiveness of the agency's techniques for identifying and eliminating any overstatements of costs or unreasonable allowances with contingencies included in the contractor's price proposal—

and so on. I am going to take all my time reading this report. It is there for the Defense Department to read. It confirms the inquiries that were made by the chairman this morning. I am sure that the Department of Defense will have pity upon the members of this committee who must report to the full Congress. So we are looking to you to supply us the expert information which you must have:

Is there a better way of purchasing these products than the way you are purchasing them? Is there a more efficient way to fight inflation by negotiation of this tremendous percentage of contracts? Is the competitive system of buying the best system? Do the Army officers who negotiate the contracts have sufficient training to make the purchasing in the public interest?

I find this sentence on page 83:

In a contract involving costs of over $150 million, the contractor did not make available for review by local agency officials the detailed information supporting estimates of cost, and the agency officials had only 6 working days to review a target price proposal.

This was a statement taken from paragraph 3 on page 83 which was entitled, "Insufficient Data and Time for Evaluating Price Proposals."

I say to you, Mr. McNeil, for the information of Secretary McElroy, that there is a wealth of information in this report from the General Accounting Office. I feel that before our committee can make any recommendation whatsoever to the whole body of Congress, we must have, and ought to have, the assistance from your Department in the form of an analysis of this report, and a statement of the steps that you are taking to carry out the recommendations made.

I am not going to spend the entire morning, Mr. Chairman, to go into the matter, but this annual report of the Comptroller General is available to every Member of Congress, it is available to you, and I think it will be invaluable if you will take this up with the Secretary and have the arrangements made for an analysis of this report submitted to us.

Mr. McNEIL. I will be very happy to do that. I would just like to add a comment at this time. This is not to depreciate that report in any way, or anything in it. Some of these things are of long standing. This problem of procurement is getting to be a tougher one as we go along in this new weapons business. I won't say we are perfect. That is the last thing I would say. These new weapons systems are taking a big chunk of our money. Even in some of the items that we don't call new any longer, such as the B–52, they are almost a proprietary item. They are really not open to competitive bidding. They are going to continue to be built, probably, by Boeing. There is no one else equipped to build them.

The same way with certain other types of aircraft. The high percentage of dollars will probably still go to negotiated type of business, or in these new weapons systems even the cost-plus-fee type, and there has been an increase in that. That does not mean we can't constantly pursue this problem.

(The information requested follows:)

DEPARTMENT OF DEFENSE STATEMENT ON GAO REPORT OF FINDINGS

Evaluations of operations within the Department of Defense which are provided by the General Accounting Office have proved to be of significant value to the Department. These reports serve two specific purposes. First, they are reviewed with respect to the deficiencies reported and the causes for these deficiencies, after which action is taken to ascertain the degree of corrective action taken within the agency of the Department of Defense upon which the report has been rendered. The second purpose of these reports is to extract, for our own consideration, problem areas which we view from the standpoint of Department of Defense policy. Causes for deficiency are analyzed and a program outline established for the development of DOD policy to fill policy void, should such exist, or to revise the DOD policy statement if such is insufficient. These reports have been most helpful in both of these respects and play prominently in our checklist for management control program development.

As a general practice, the General Accounting Office refers its findings to the agency of the Department of Defense upon which the report is rendered for review and comment. In turn, such agencies supply to the General Accounting Office their analysis of the problems and recommendations along with action taken or initiated to correct unsatisfactory condition cited by the General Accounting Office. The General Accounting Office then includes in its final report the comments and status of action provided by the Department of Defense agency.

The following statements address themselves to the specific areas of criticism reported on by the General Accounting Office in its 1958 report of findings. As submitted, each statement, in its heading, refers to the page in the General Accounting Office report in which the criticism appears, and is transmitted in numerical page order.

PAGES 1 TO 3, INCLUSIVE: MILITARY ASSISTANCE PROGRAM

The Assistant Secretary of Defense (International Security Affairs) ASD (ISA) points out that, thus far this spring, three separate sessions with the House Foreign Affairs Subcommittee have been held, during which time the current reports on the military assistance program have been exhaustively reviewed and the Department of Defense positions made clear. Because of the complexities involved, the ASD (ISA) is prepared to testify before the Joint Economic Committee on any aspect of the military assistance program which the committee is interested in pursuing.

PAGE 4: CONTINUING PROBLEMS IN REDISTRIBUTING EXCESS SPARE PARTS AMONG THE MILITARY SERVICES

The GAO report is correct in its observation that unresolved problems, particularly the lack of a mandatory exchange of information regarding long supply assets, affected the maximum utilization of existing Department of Defense stocks at the time of the GAO 1958 investigation.

This situation was recognized by the Department of Defense as requiring attention leading to a workable and effective solution. Towards these ends, the Secretary of Defense issued a new comprehensive policy directive on January 27, 1959, entitled "Policies for the Transfer of Department of Defense Supply System Inventories." As its title implies, this Directive establishes basic policy for the transfer of Department of Defense supply system inventories. It alters previous policy statements regarding reimbursement requirements between the services and specifically provides for—.

(*a*) Categorization of property as either "transferable-reimbursable" or "transferable-nonreimbursable," together with criteria for such categorization which is based on depth of supply;

(*b*) Transfer of property between inventory managers in keeping with (*a*) above, irrespective of its character (i.e., stock fund or appropriation financed);

(*c*) Reimbursable release of certain stocks held for mobilization reserve proposed together with reinvestment authority for proceeds so generated when necessary under authorized procurement programs.

(*d*) The basis on which excess stocks will be programed and transferred to military assistance programs;

(*e*) The basis for transfer of property to other Federal activities.

In terms of the GAO report, this directive provides specifically for the redistribution of all long stocks between inventory managers without reimbursement. Implementing instructions are currently under preparation. These, in addition, to the basic directive itself, should contribute in large measure to the resolution of problems cited by the GAO in its report.

PAGE 5: INADEQUATE CONSIDERATION OF AVAILABLE COST INFORMATION IN NEGOTIATING CONTRACT PRICES

The report statement of the GAO involves two policy matters: (*a*) That cost information available to the contractor after the date set for the establishment of the redetermined price should be received and utilized in the redetermination of prices; and (*b*) that contractors have withheld information other than appeared in their "formal books and records" and that such records, if disclosed, would have resulted in reductions in the negotiated prices.

Both these have been brought to the attention of the Department of Defense previously. Both relate to contract provisions for the cost support of price redetermination. We are currently in the process of publishing a Department of Defense family of price redetermination clauses. A typical provision of these clauses, pertinent to the GAO statement reads as follows:

"PRICE REDETERMINATION. Not more than ______ days nor less than ______ days before the end of each redetermination period, except the last, and as otherwise provided in (iii) below, the contractor shall submit:

"(i) proposed prices for supplies which may be delivered or services which may be performed in the next succeeding period under this contract, together with—

"(A) an estimate and breakdown of the costs of such supplies or services on DD Form 784 or in any other form on which the parties may agree;

"(B) sufficient data to support the accuracy and reliability of such estimate; and

"(C) an explanation of the differences between such estimate and the original (or last preceding) estimate for the same supplies or services.

"(ii) a statement of all costs incurred in the performance of this contract through the end of the __ month prior to the date of the submission of proposed prices, on DD Form 784 or in any other form on which the parties may agree, together with sufficient supporting data to disclose unit costs and cost trends for—

"(A) supplies delivered and services performed; and

"(B) inventories of work in process and undelivered contract supplies on hand (estimated to the extent necessary);

"(iii) supplemental statements of costs incurred subsequent to the date set forth in (ii) above for—

"(A) supplies delivered and services performed; and

"(B) inventories of work in process and undelivered contract supplies on hand (estimated to the extent necessary);

as and to the extent that such information becomes available prior to the conclusion of negotiations on redetermined prices; and

"(iv) any other relevant data which may reasonably be required by the contracting officer.

Upon receipt of the data required by this subparagraph (c), the contractor and the contracting officer shall promptly negotiate to redetermine fair and reasonable contract prices for supplies which may be delivered and services which may be performed in the period following the effective date of price redetermination. Where the contractor fails to submit the data as required above within the time specified, payments under this contract may be suspended by the contracting officer until the data are furnished."

With respect to currency of information, it is to be noted that the Department of Defense has accepted the desirability of receiving from the contractor the latest "current" cost information in (iii) above.

With respect to receiving and utilizing cost data other than that which appeared in the contractor's "formal books and records," the GAO in its report to the Department of Defense described the records as "working papers." The Department of Defense response was to the effect that adoption of the above clauses, particularly (i)(B) which requires that the contractor supply "sufficient data to support the accuracy and reliability of such [cost] estimate," and (iv) "any other relevant data which may reasonably be required by the contracting officer," were sufficiently broad to cover whatever cost data is required.

We believe that the publication of the clauses solves both problems.

PAGE 6: INAPPROPRIATE USE OF FIXED-PRICE CONTRACTING

The GAO report notes that there is included in the Armed Services Procurement Regulation (pt. 4, sec. III), guidance with respect to the selection of contract types. The conclusion is reached that "additional guidance is needed," because firm fixed-price contracts were utilized in nine instances during a 2-year period which the auditor believed should have been on another basis. The auditor further believed that this action resulted in excessive pricing of approximately $3,800,000.

During the period in question, there were about 8 million procurement transactions awarded of which nine improper judgments relating to types of contract are alleged to have been found. Again, during the period in question, procurement awards amounted to approximately $40 billion.

The general policy with respect to the use of types of contracts is included in part 4, section III, Armed Services Procurement Regulation. This part includes basic direction with respect to the use of all authorized types of contracts. It includes specific direction that the "selection of a contract type is generally a matter for negotiation. The proper selection of an appropriate type of contract is of primary importance in obtaining fair and reasonable prices under all of the circumstances." In other words, the selection of a contract type is the subject of bargaining in relation to the transaction itself, and actually is very critical in the determination of the bargaining for the price which follows. From the record at hand, it it not clear the extent to which the negotiators for the contractor pressed for the utilization of the firm fixed-price-type contract. The Department of Defense feels that the contracting officer ought not to determine unilaterally the type of contract to be employed to cover a contract being "negotiated."

We believe that the Congress has made it clear through the years that the firm fixed-price-type of contract is to be preferred over all others to the extent that it may be deemed that the price agreed upon is reasonable under the circumstances. It must be recognized that this type of contract imposes the greatest risk upon the contractor, and thereby the greatest incentive for superior production at the least cost. As a matter of fact, on the basis of the studies which we have made pursuant to the administration's project to reasonably stabilize prices, we have come to the conclusion that this can be done only by the use of more, not less, firm fixed-price-type contracts. While it is true that there can undoubtedly be occasional high prices resulting from this attitude, we have concluded that in the overall, the imposition of real incentives to save will result in less costs. To the extent that there may be an occasional higher price, it will not persist since the followon procurement pricing will be predicated upon the cost experience under the initial procurement.

In reviewing the direction respecting guidance for the selection of contract types, the Department of Defense feels it is adequate as currently stated.

PAGE 6: COLLECTION OF RENT FOR COMMERCIAL USE OF GOVERNMENT-OWNED FACILITIES

It is true that out of the large number of Government contracts involving the use of facilities, occasional discrepancies can arise. However, to the extent they may exist, these should become minimal as new contracts are written under the more definitive policy guidance which has been set forth in our Armed Services Procurement Regulation (ASPR) in the recent past. These provisions, developed in coordination with the military departments, replace individual departmental procedures and adequately cover the discrepancies GAO noted in its report.

In this regard, section XIII of the ASPR, specifically part 6, states, "whenever industrial facilities are made available for use on work other than for an agency of the Department of Defense, the user shall be charged a fair and reasonable rental * * *." As further elaboration, these provisions require that charging for that portion of facilities constituting "real property" is to be on the basis of sound commercial practice, including the use of any prevailing commercial rates. However, in accordance with the provisions of the law (10 U.S.C. 2667) concerning the leasing of Government facilities for commercial use, the rental charge may take into consideration obligations assumed by the user to protect and maintain the property as well as to perform other services as all or part of the consideration for the contract or agreement. In any event the rental charge shall be such as to prevent the user from obtaining an unfair competitive advantage over competitors who own their facilities or obtain them from private sources. These provisions are applicable regardless of how little or how much the property is used for commercial purposes.

These same requirements also apply to "personal property" that may be used for commercial purposes and specific rental rates are prescribed. In the case of "production equipment," the rental rates supplement any obligations undertaken by the user to provide maintenance or other services.

In response to the suggestion that a special study of the problem be undertaken by the Department of Defense, it is important to note that our policies and the implementations thereof are under constant review. For example, the matter of accounting for and managing Government-owned industrial facilities has been exhaustively studied by an interdepartmental working group. The report was submitted in June 1954 to the Office of the Secretary of Defense and many of the provisions now incorporated in our regulations are an outgrowth thereof. In addition, the ASPR committee is presently preparing further detailed guidance for publication in order to assure that any competitive advantage that one firm may obtain by virtue of having Government-owned facilities is minimized.

Moreover, steps have recently been taken to review departmental implementations of DOD basic procurement policies in order to ascertain if further guidance may be required. Similarly, departmental audit and inspection activities are charged with following up contractual actions to assure that they are made in accordance with regulations.

It is the DOD's intention to take every reasonable action to follow up on specific cases or on deficient policies as they are ascertained to be certain that the DOD collects appropriate revenues for the use of its facilities with minimum administration costs.

PAGES 7 TO 9, INCLUSIVE: SIGNAL CORPS SUPPLY DEFICIENCIES

The Department of the Army has submitted the following comments regarding the criticisms raised by the General Accounting Office.

*Comments*

A brief review of the events leading to the conditions cited by the General Accounting Office is considered pertinent before dealing with the specific criticisms. For instance, rollup stock turned in by troop units at the end of World War II was consolidated at Hanau Signal Depot, Germany. The classification, taking of inventory, and the establishment of stock records for these rollup stocks presented a task of considerable magnitude. However, in 1951 and before that task was completed these stocks were redistributed from Hanau Depot to Saumur, Verdun, and Pirmasens. Since the German people from Hanau could not be transferred to France with the stocks the task of segregation, classification, and taking of inventory of these stocks was further delayed by lack of trained personnel at the new locations. Training of both French civilian and U.S. military personnel was accomplished concurrently with the purification of the stocks. During the period when these stocks were being classified and inventoried the supply records of the Signal Supply Agency, Europe, were, of necessity, based on the best information available. Conditions were further complicated by the fact that substandard storage facilities were encountered at both depots in France. This resulted in a diversion of personnel from classification and inventorying of stocks to a maintenance-in-storage program to minimize deterioration of stocks. As progress was made in purifying inventories and classification of stocks at these depots, the records of the Signal Supply Agency, Europe, improved accordingly. It has not been possible to expend full effort to establish perfect procedures.

The performance of the Signal Supply System in Europe has steadily improved. As evidence of that improvement the actual issues to using units in Europe plus stocks declared excess have exceeded the volume of supplies requisitioned from the United States depots for replenishment to the European depots. This has resulted in a significant reduction in total stocks on hand. For instance, at the time of the General Accounting Office report the total inventory was estimated at $108 million whereas it was $86.1 at the end of December 1958. Likewise, the $42 million of items in excess of requirements reported by the General Accounting Office, had been reduced at December 31, 1958, to $21 million, $13 million of which has been declared to other agencies.

Since the 1955 visit of the General Accounting Office team, the Signal Supply Agency, Europe, has taken action to correct the legitimate deficiencies reported by the team, but what is more important has initiated an intensive program for improvement of operational management to preclude recurrence of similar instances. Some of the more important actions taken are cited in this statement. Recruitment and training of indigenous employees to provide continuity has been especially emphasized. Such a program could not be expected to produce positive results immediately. After a period of 3 years of intensive training efforts, the positive results are becoming apparent. These will now increase proportionately in the months to come.

Comments concerning the specific criticisms follow:

1. *Inaccurate and unreliable records.*—Procedures have been strengthened to provide for timely recording of all transactions. Training and orientation classes have been conducted for supply management, storage, maintenance, and inspection personnel to assure understanding of the applicable procedures. Guidance and assistance has been given to supervisory personnel in review and analysis, methods analysis, and charting techniques to facilitate the early detection of errors and to improve the quality of supervision of supply performance. Cross referencing of records to show acceptable substitute items has also been completed.

2. *Ordering unneeded supplies from the United States.*—Cross referencing of records so as to facilitate identification of acceptable substitute items has been completed. This will expedite supply and reduce number of dues out and reduce overall inventory. Arrangements have been made by the Chief Signal Officer through the U.S. Army Signal Supply Agency, Philadelphia, Pa., to furnish listing of equipment allowances pertaining to the theater for comparison and correction of COHZ Signal Supply Control Agency's records. U.S. Army Signal Supply Agency, Philadelphia, has furnished guidance and supervision in the preparation and review of supply control studies so as to establish most accurate basis for ordering supplies. Other actions which have been taken to correct this condition are establishment of commodity manager staff under the recent reorganization of the Signal Supply Agency, Europe; staffing of key positions with technically trained personnel; establishment of closer liaison with customer agencies; revision of controls to segregate high and low dollar value stocks in processing of supply documents. Training courses have been conducted to improve technical competency of operating and supervisory personnel and a committee has been established, composed of management personnel to review and approve high dollar value requisitions prior to release. A followup system for canceling quantities due in when changes occur in customer requirements. Increased emphasis is being directed to this aspect of control so that this should cease to be a problem.

3. *Unnecessary reservations of stock.*—The Department of the Army has provided the Signal Supply personnel in Europe with the most recent guidance on computation of special reserves. On-the-spot instructions have been given in

the proper application of these procedures. Procedures for conduct of periodic review of stocks held in reservation codes have been established. The reviews are being conducted on a continuing basis. When reserve stocks are identified as no longer required for the purpose for which reserved, supply levels are reviewed for possible excess and necessary disposal action taken, where indicated. Closer monitorship of stocks held in account codes will be accomplished under the commodity management system. This system will provide continuous review by technically qualified personnel to insure the integrity of the reservation accounts.

4. *Lack of adequate storage plans.*—Complete plans for depot operation, including a storage plan for the new warehouses at Montreuil-Bellay, France, have been developed. A representative of Department of Army visited the European area and assisted with the development of the plans. These plans provide for the shipment of stocks into the new warehouses, operations layout, locator system, and equipment and personnel requirements. Assistance was also given in the following areas: Warehouse planning; space utilization; layout palletizing; storage practices for vehicles and power units and other supplies and equipment; inventory procedures; receiving, shipping, and stock-selection methods; various administrative forms; depot organization; depot improvement; construction of steel storage racks; locator cards; and safety instructions and safe storage practices for MME equipment and flammable materials.

Information concerning the technical description and unit cost of all supplies and major items of equipment required for Montreuil-Bellay was also furnished. Discussions were held with operating and supervisory personnel concerning this plan and, where necessary, agreements and recommendations were confirmed in writing or by development of formal procedures. Department of Army proposes to furnish continued assistance with the full implementation of this plan. This plan will be used as a guide in improving operations in the other depots.

PAGES 10 AND 11: EXCESSIVE COSTS INCURRED IN PROCESSING PAYROLLS FOR CIVILIAN EMPLOYEES OCCUPYING UNGRADED POSITIONS

The Department of the Navy's position concerning the subject General Accounting Office criticism is set forth below.

By letter of October 24, 1958, the Comptroller General requested the Department of the Navy to reconsider its policy of paying ungraded employees on a weekly basis. The letter noted that a 1955 study estimated annual savings in excess of $1 million if a biweekly pay system were adopted, but also recognized that employee morale and certain other factors not readily measured in dollars required consideration in arriving at a decision. In a letter dated January 13, 1959, the Assistant Secretary of the Navy (Personnel and Reserve Forces) advised the Comptroller General that it was not considered in the best interests of the public or the Navy to adopt a biweekly pay period system for ungraded employees, and stated the reasons for that decision.

The question of adopting a biweekly pay period system for ungraded employees has been considered on several occasions in the past, and, prior to the above-mentioned decision, most recently in 1955. The previous decisions to continue weekly pay periods were based upon all known facets and effects of converting to a biweekly system as opposed to maintaining the status quo.

Following receipt of the Comptroller General's letter, the Navy conducted a thorough review of the bases of its policy in this matter. This review included obtaining the opinions of various naval bureaus and offices which have management cognizance over the field activities employing ungraded workers. In accordance with the White House policy relative to soliciting and considering the views of employee groups in the formulation and adjustment of personnel policy, the Navy also secured the views of the major employee groups. The majority of the naval bureaus and offices favored continuing the existing policy. Employee groups were unanimously and strongly opposed to changing ungraded employees from a weekly to a biweekly pay period system.

As a result of the review, it was determined that employee-management relations considerations required at least equal weight with fiscal and accounting considerations in deciding if the Navy should adopt a biweekly pay system. The review also resulted in the following conclusions:

1. It is prevailing private industry practice to pay shop-type employees on a weekly basis, and the practice has become almost standard during the last 30 years. In 1929, 57 percent of the Nation's factory workers were paid on a

weekly basis. Surveys of 17 major industrial areas conducted in 1954–55 by the Bureau of Labor Statistics indicated that 91 percent of the plant workers of the companies contacted were paid on a weekly basis. It is believed that the Department of the Navy should follow the prevailing private industry practice unless there are compelling reasons for doing otherwise. In view of the very strong trend toward weekly pay periods during the past three decades, a change to a biweekly pay system would be a backward step in terms of employee-management relations.

2. A change to a biweekly pay system would have a profoundly disturbing effect upon the morale of the Navy's ungraded employees. Depressed employee morale typically results in reduced efficiency, lowered productivity, and an increased number of grievances and complaints, all of which are items of expense, even if they cannot be readily measured in terms of dollars and cents. The fact that the lowered morale condition would be temporary in nature does not alter the fact that it would be expensive. Moreover, a management action producing lowered morale permanently impairs the employer's reputation, in the eyes of both present and future employees.

3. There is some question as to what the actual dollar savings realized from the adoption of a biweekly pay period system would be. The 1955 study indicates that the principal savings would result from the smaller number of man-hours needed to prepare 26, rather than 52, payrolls a year, and from the elimination of peak workloads by preparing graded and ungraded payrolls on alternate weeks. While biweekly pay periods would certainly reduce the number of man-hours devoted to payroll preparation, it does not necessarily follow that the Department of the Navy's costs would be reduced by the dollar equivalents of the saved man-hours. It was recognized in both the 1955 study and the recent study that such savings would be realized only to the extent the saved man-hours added up to the positions which could be eliminated. Except in naval activities with large payroll staffs, the change would not result in the elimination of any substantial number of positions. In most cases, the saved man-hours would merely be available for other purposes. While this would be desirable, it would not produce dollar savings. Moreover, any savings resulting from reduced payroll preparation costs would be at least partially offset by the cost of lowered employee morale.

4. The change would work a hardship on many of the Navy's employees who are accustomed to weekly paychecks and have arranged their financial affairs on that basis. Even a gradual transition in which pay periods were successively lengthened by 1 day for a 5-week period would probably not materially lessen the hardship. To a lesser extent, the change would also affect the economies of areas in which large numbers of the Navy's employees reside, since the merchants with whom the Navy's ungraded employees deal have undoubted accommodated their business transactions to a weekly frequency of buying and bill paying. Even though this hardship upon employees and the community would be temporary, it would be severe. Moreover, it would in many cases impose additional expense upon the employees, since many of them would be forced to borrow money at high rates of interest to tide them over the transition period.

On the basis of the foregoing, the Navy considered it undesirable to convert its ungraded employees from a weekly to a biweekly pay period basis, and so advised the Comptroller General. The Navy continues to adhere to this position.

PAGES 12 AND 13: SUPPLY MANAGEMENT DEFICIENCIES

*A. A need for reevaluation of certain aspects of program life provisioning policies*

In letter of November 21, 1958, the Secretary of the Navy promulgated a broad 17-point program for the improvement of aviation supply support in the Navy. Point No. 10 of the Secretary of the Navy's program is quoted herewith:

"Study program life concept with view to limiting concept to high-cost long leadtime items."

In the first progress report on the 17-point program, the Chief of Naval Material has reported as follows:

"The Chief of the Bureau of Supplies and Accounts has reported that the range and depth of new items introduced into the supply system through provisioning has been limited to quantities necessary to support end items during an initial period of service. This is defined as being the period necessary to collect usage data which would permit the support of the end item through cyclical replenishment. BUAER and ASO are presently provisioning on the basis of a limited stock level plus initial outfitting requirements except in those instances where it is established that life of type procurement is the most economical course of action." The Chief of Naval Material has indicated that further progress reports will be made on this item to the end that the objective expressed by the Secretary of the Navy's program for the improvement of aviation supply support in the Navy is achieved in all provisioning actions.

*B. Difficulties in appropriation administration*

This problem was also spoken to by the Secretary of the Navy's 17-point program for improvement of aviation supply support in the Navy and was listed as point 3 "Arrange to fund 'annual appropriation' spares through one appropriation with ASO to have authority for budget preparation and defense for 'R' cognizance items." In the first progress report under this program, the Chief of Naval Material reported to the Secretary of the Navy as follows:

"The Bureau of Aeronautics in submitting its fiscal year 1960 budget estimate to the Secretary of Defense proposed transferring replenishment airframe spare parts support from the annual 'Aircraft and facilities, Navy' appropriation to the continuing 'Aircraft and related procurement, Navy' appropriation, and included a separate line item in this latter appropriation for airframe and engine replenishment spare parts.

"Under this proposal, positive identification of aircraft support coverage under the two principal aviation appropriations would have been provided. Although the Department of Defense and the Bureau of the Budget concurred in establishing a separate line item in the 'Aircraft and related procurement, Navy,' appropriation to cover replenishment requirements for engine spare parts, the Navy's proposal to transfer replenishment airframe spare parts support from the 'Aircraft and facilities, Navy' appropriation and to consolidate these requirements under the 'Aircraft and related procurement, Navy' appropriation was disapproved. The Chief of the Bureau of Aeronautics has indicated that he will continue to press for the consolidation of naval aircraft replenishment support under a single appropriation, 'Aircraft and related procurement, Navy.'

"The Chief of the Bureau of Aeronautics has indicated that detailed development of aircraft spare parts support requirements is the responsibility of the Aviation Supply Office. Review and defense of these requirements is the joint responsibility of OPNAV, BUAER, and ASO. The proposed fiscal year 1960 budget was developed and defended in this manner and any further budgets would be similarly handled."

In addition, in a letter dated January 29, 1959, to the Honorable Joseph Campbell, Comptroller General of the United States, the Assistant Secretary of the Navy (Financial Management), stated in part:

"The advantages and overall effects of such a change in funding are being intensively studied. If this study confirms that significant improvement can be gained by review in the source and manner of funding, appropriate adjustment will be made when the budget estimates for fiscal year 1961 are formulated."

The determination of the Chief of the Bureau of Aeronautics to continue to press for the funding of aircraft spares through a single appropriation, coupled with the fact that the Office of the Navy Comptroller has indicated that adjustments will be made in the budget estimates for fiscal year 1961 if it is determined that significant improvement can be attained thereby, indicates that all possible action is being taken by the Department of the Navy at this time.

PAGE 14: SHIPBUILDERS REQUESTS FOR PRICE INCREASES NOT ADEQUATELY SUPPORTED

This finding of the General Accounting Office is related to contract price adjustments due to costs resulting from delays in supplying contractors with needed plans and materials. Navy comments in regard to specific recommendations are given below. In order, however, that there may be a better understanding as to the climate surrounding the award and performance of the contracts in question, which aggravated normal problems in this area, the following information is submitted.

The private shipbuilders that submitted the claims in question, hereinafter referred to as delay claims, were constructing, or had constructed, ships for the Navy under fixed price contracts. The General Accounting Office review consisted of an examination of delay claims arising from 14 such contracts awarded in 1951 and 1952 and 1 contract award in 1954. These claims were settled by the Navy Bureau of Ships during the 16 months ended October 31, 1956.

At the outset of the Korean emergency, it was determined that additional ships were required to bring the fleet to proper strength. Also, more ships were required for the mutual defense assistance program (MDAP). When congressional approval for funds had been obtained for these shipbuilding programs, the Bureau of Ships started procurement action and in 1951 and 1952 issued a large number of contracts for ship construction. Among these were a number of contracts for the construction of wooden and other smaller ships such as nonmagnetic minesweepers, tugs, landing craft, whaleboats, air rescue boats, patrol boats, and steel passenger and cargo boats. Many of the shipbuilders who participated in these ship construction programs were small shipyards that had been comparatively idle since World War II but had the facilities necessary to construct these types of ships.

Since in many cases the need for these ships was considered urgent, the Navy adopted a number of procedures and methods designed to permit earlier completion of these ships. While these procedures and methods resulted in earlier completion of the ships than would have otherwise been possible, many of the ships were delivered considerably later than originally scheduled. A great many of the contractors who participated in these programs asserted that the principal cause for the late delivery of these ships was the late receipt of working plans and materials which were furnished by the Government and further claimed that the late receipt of Government-furnished plans and material disrupted their normal construction progress and caused them to incur additional costs. The delay claims in question were submitted by these contractors to obtain reimbursement for those additional costs.

The General Accounting Office report made three specific recommendations which are set forth below followed by the Navy comment in regard thereto.

1. That the Bureau issue instructions for the guidance of contractors in preparing delay claims. These instructions should provide for the accumulation of substantiating data at the time the delays are occurring and should provide standards for the information required to establish adequately the cause and extent of delays and the resulting damages from each delay.

The Navy Department concurs in the objective of this recommendation and will take such administrative steps as are believed to be proper to place the contractors on notice that records of events which might ultimately become the basis for claims be properly documented at the time of their occurrence. Instructions to supervisors of shipbuilding in this connection will also be amplified. It must be borne in mind, however, that issuance of instructions to contractors in regard to their preparation of claims is limited to quite a degree by statute (18 U.S.C. 283), which prohibits our participation in the preparation of claims against the Government.

2. That the Bureau direct the SupShips to evaluate the damages suffered by the contractors at the time the delays are occurring.

The Navy Department concurs in this recommendation and action is being taken to tighten up our instructions to insure that records are maintained which will be as detailed and complete as reasonably possible to facilitate the evaluation of claims if and when presented.

3. That the Bureau encourage contractors to submit their claims within reasonable periods after the termination of the delays so that settlements can be negotiated before the details of the causes and effects of the delays are forgotten by those concerned.

Generally, the Navy Department concurs in this recommendation. Its implementation, however, must be very judicious since a requirement that contractors submit claims within a short time after occurrence of a delay may induce contractors to initiate claims, whether valid or not, in order to protect their interest against the time when actual costs incurred in the performance of the contract have been fully developed. Accordingly, it is proposed to handle this problem by a discussion thereof in an administrative procedural manual now under preparation.

PAGES 15–16: EXPENDITURES FOR REPAIRING OLD VEHICLES GREATLY IN EXCESS OF PRICE OF NEW VEHICLES

It is recognized that, during the several years prior to fiscal year 1959, the Air Force did not procure sufficient vehicles to replace those which could no longer be economically retained. This resulted from efforts to remain within established overall budgetary limitations, as well as program fluctuations during this period. The forced retention of certain vehicles beyond the point of economical return established by Department of Defense Instruction 4150.4, April 6, 1955, required expenditures of maintenance funds beyond that which would have been required if adequate replacement vehicles were furnished.

The statement that the annual cost of maintaining the vehicle fleet is apparently well over $100 million is misleading. The complete vehicle fleet is composed of many high-cost vehicles used in servicing and maintaining aircraft and missiles, as well as the automobiles, trucks, and construction equipment with which this report is concerned. The latter vehicles are relatively simple in design with low cost, commercially available parts and are susceptible to periodics replacement. When the Air Force recognized that general-purpose vehicle replacements were not forthcoming, it was determined that only minimum repairs as necessary for safe operation would be accomplished until replacement vehicles were furnished. As the replacement lag time extended, the maintenance expenditures generally increased; however, these expenditures were necessary to insure that the vehicles were safe and in a satisfactory operating condition.

The last substantial buy program providing the Air Force with modern general-purpose vehicles occurred in fiscal year 1952. A preventive maintenance program was designed to keep pace with an orderly replacement program, phasing out these vehicles at the end of their economical life.

Controls on vehicle maintenance are exercised through directives which prescribe specific maximum allowable expenditures for maintenance of each class of vehicle rather than through the media of budgeting controls. However, as noted above, waivers to the maximum allowable expenditures must frequently be granted in order to maintain older vehicles in a safe operating condition.

Based on maintenance cost data identifying this problem area, the current fiscal year 1959 program provides $63,714,000 for 15,943 vehicles in the P–220 and P–270 budget areas. The fiscal year 1960 budget contains a request for $57,905,000 for 11,723 vehicles to provide the second phase of an orderly replacement program. Phasing of replacement vehicles in this manner will prevent reoccurrence of a large one-time procurement similar to the 1952 experience which results in a large number of vehicles requiring simultaneous replacement.

Vehicle cost data required by the Office of the Secretary of Defense has been expanded to provide inventory maintenance and operating cost data by year model. Using this data, trends can be factually established as a basis for requesting funds for timely replacement of all vehicles in the Air Force inventory.

PAGE 17 AND 18: SUPPLY DEFICIENCIES IN THE IMPLEMENTATION OF IMPROVED LOGISTICS PROGRAM IN THE EUROPEAN THEATER

Most of the conditions cited in the GAO report were in existence at the time of the Air Force review of supply operations at European depots in the spring of 1957, nearly 2 years ago. At that same time period, or during the latter part of May and early June 1957, the Deputy Chief of Staff, Materiel, Headquarters United States Air Force, together with his Directors of Supply and Maintenance, made a staff visit to the area and visited Headquarters, USAFE; Headquarters of the Air Materiel Forces, Europe, in Wiesbaden; the depot at Chateauroux (CAMAE); and the Northern Air Materiel Area, Enrope (NAMAE) at Burtonwood.

It is significant to note that the conditions which are detailed in the GAO report were also noted by this staff team at the time of their visit. While the length of their visit precluded securing details such as those covered by the GAO report, the Air Force DCS/Materiel party did note the general conditions which, it was realized, could cause deficiencies such as those outlined by the GAO. As a result, the Air Materiel Command was immediately directed to review the phase-out plans for both Burtonwood and Nouasseur, and to take energetic steps to stop shipments of unnecessary stocks to these two depots; to identify items which should be returned to the United States or redistributed in Europe; and to identify items which should be determined as surplus and disposed of accordingly. A followup visit to Nouasseur was made by senior members of the Air Staff later in September 1957. Senior members of the Air Materiel Command staff made a similar visit in the latter part of September and early October 1957. The purpose of these visits was to determine the effectiveness of the action taken during the summer by the Air Materiel Command; to eliminate such conditions as were then foreseeable; and to initiate action to preclude such conditions from arising in the future.

The measurable improvements in operations, effectiveness, and economy that resulted from consolidating the Air depot activities in the European Theater under the Air Materiel Command, thus removing them from the control of the theater commander, have proven to be significant and have demonstrated the wisdom of this decision. Since one of the first actions taken by the Air Materiel Command was to phase down the huge depot stocks in the European area which had been accumulating under theater policies and programs since 1948, and since this action was in the early stages of implementation of the time of the visits by both members of the General Accounting Office and by the Air staff, there were many details that needed to be straightened out. For example, there were understandable differences between theater policies and Air Force policies covering depot operations. This created some difficulty on the management side, especially at Headquarters, Air Materiel Command. During the early part of 1957, action had been initiated to eliminate the areas of confusion resulting from these different policies. The effectiveness of those Air Force policies and programs, which were in the process of evolution and formulation in the first 6 months of 1957, have since been demonstrated as is evidenced by the GAO followup report dated July 17, 1958, on Nouasseur. This followup report stated that all major deficiencies reported previously had been corrected and was, in fact, commendatory of the actions taken. We have since determined that the same significant improvement in the phase down operations has taken place at Burtonwood and Chateauroux.

The Air Force Inspector General is currently conducting a survey of European depots and advance information indicates that actions to complete the phase out operation are proceeding in a satisfactory manner. The account at the SAMAE depot at Nouasseur has had final audit and all assets still required within the Air Force and other Government agencies have either been returned to Air Force stocks or redistributed to fill other agency requirements. However, some residue stocks are still being disposed of by the marketing activity at that depot. The CAMAE depot at Chateauroux and the NAMAE depot at Burtonwood are phasing out gradually and appear to be making the best possible utilization of available assets. The Inspector General is also reviewing records at stateside depots to complete the investigation of conditions mentioned in the GAO report.

The Air Staff and Headquarters, Air Materiel Command have made frequent and lengthy staff visits to the area depots in Europe and the Pacific since 1957. As a result, some very significant improvements in disposal policies, especially in the United Kingdom, have been approved by the Department of Defense and by the State Department, and changes in intergovernment agreements have grown out of these visits.

Appropriate action to correct these deficiencies was well underway at the time of the GAO review. Results since then have confirmed this statement.

PAGE 19: EXCESSIVE COST OF PRINTED TECHNICAL DATA OBTAINED THROUGH PRIME CONTRACTORS

The objective of the Air Force in procuring printing and distribution of technical data from prime contractors was improved service through the merging of the manufacturing and printing responsibilites in order to insure simultaneous delivery of the equipment and technical publications. Experience had proven that the normal method of procuring directly with printing concerns and suppliers of copies of technical data could not accomplish this to a satisfactory extent. The objective was attained to a gratifying degree, with the overall time required for printing and distribution reduced from an average of 60 days to 20 days.

Notwithstanding the above, at the time the report was processed, the following actions were taken with regard to the policy on procuring the printing and distribution of technical data from prime contractors:

(*a*) The experience and recommendations of procuring activities purchasing the printing and distribution of technical data from both prime contractors and commercial printing firms be solicited and evaluated.

(*b*) The policy of procuring printing and distribution of technical data from prime contractors rather than from commercial printing firms be reexamined and the policy revised if the facts warranted.

The target date for completing these actions has been established as March 2, 1959, and further comment on this item will be available as soon as the above actions have been evaluated.

PAGE 20: LACK OF STANDARDIZATION OF AIRCRAFT COMPONENTS AND ACCESSORIES

We appreciate the contribution of the Comptroller General to the standardization effort through his findings in the fuel-pump area. The reduction of items of that category in the supply system were very significant as has been pointed out. It is also significant, however, that this area lent itself very well to that reduction effort due to past accumulations and being more simple in an overall area of relatively complex equipments.

The technique utilized in the pump reduction is being followed by the preparation of specifications to serve as the controls limiting reentry into the supply system. This same overall approach has been applied in other areas through scheduled projects spread over the period fiscal year 1959 through fiscal year 1962. Though elimination of the needless and excess items from existing inventories is mandatory, our greatest concern must be directed toward the reentry problem. As stated by the Comptroller General, we have been in repeated contact with the aircraft industry in regard to the matter. In those contacts our emphasis has consistently been placed on reducing the number of items in the supply system by limiting reentry and introduction of new items.

The foregoing, though general, is presented as an indication of our approach to this matter. That approach has been followed by the following specific actions:

A. Establishment of scheduled projects over the period fiscal year 1959–62. Work has commenced on those projects.

B. Solicitation and receipt of recommendations from the aircraft industry pertinent to the problem and an indication of industrial contribution toward resolution.

C. Initiation of a project to determine the feasibility and control of standardization during the weapons systems development process by contractural means.

D. Finally, though not stemming directly from the pump disclosures, we are presently preparing a technical information file on "in-house" equipments peculiar to ground-support equipment. This file, when accomplished, will be furnished to the manufacturer to insure the use of such in-house items during the design and fabrication of new equipments. We are optimistic about the successful results of this test project. Other areas will be treated likewise if those results prove economical.

Though we are attacking an area that is admittedly complex and fast changing due to advancing technology and new developments, we are convinced that much can be done in the way of standardization and control of aircraft components and accessories. Due to those same conditions we are also convinced our efforts must be guided by determination; firm methods; and proven results, both economically and operationally; as opposed to hastily instituted crash programs. In this connection we quote the following from our comments of May 1, 1957, to the Comptroller General:

"* * * an active standardization program must be maintained by the Air Force for a long continuous period if the maximum degree of standardization possible and desirable is to be attained in contractor-furnished equipment under the weapons system concept of procurement. Current estimates indicate a minimum of 5 years will be required before significant results can be obtained from such a program."

Our position reflected by those comments remains unchanged. However, we do feel that we are making headway in this matter through the approach and the actions we have taken.

Senator O'Mahoney. You will recall the statement of the Comptroller that the expenditures for the Department of Defense constitute a tremendous proportion of the total expenditure.

Mr. McNeil. They do.

Senator O'Mahoney. If we are going to balance the budget we have to find a way to raise the money, not only to pay the interest on the debt, but if we are to defeat what the Soviets seek to have happen in this country, we have to raise the economy to a level on civilian phases that will produce the income by which we can balance the budget. It is one thing to say we are presented a balanced budget, and it is another thing—altogether another thing—to figure out when it will be possible at the rate presented in this budget to pay off even a quarter of the national debt.

Mr. McNeil. We, in the Department of Defense, certainly have a real stake in the stability and the value of the dollar and an increase in the income and productivity of the country. We have a very great stake in it. In this long-range job we have, that is, keeping a strong Military Establishment, we have a real interest in seeing that the economy can continue to support it for so long as we are in trouble in this world. We just must. It is vital.

Representative Bolling. Mr. Chairman, I regret that I was not here for all of the testimony of the Secretary, but there is one sentence in your statement which is so sweeping in its implications that I would like to call attention to it, and ask some questions. It reads:

> These are some of the reasons why our military leaders feel that regardless of who might strike the first blow and regardless of the number of ICBM's an enemy might use against us, this Nation will continue to have a retaliatory force sufficient to strike a decisive blow.

My quarrel with the statement is that it is so sweeping, "regardless of the number." It seems to me quite possible that if a very large number of ICBM's would be used there would be some serious question as to how decisive our retaliation would be.

Mr. McNeil. I think it probably is lacking in one phrase, although it is a statement that the Chairman of the Joint Chiefs of Staff and others have used. It has to be read in the time frame of 1960. We are talking about the 1960 budget, and what we will buy in the 1961 and 1962 period as compared to our opposition. We are not talking about 1965 or 1970.

Representative Bolling. This is based on an estimate of how many ICBM's they can have in that period?

Mr. McNeil. That is right. On the basis of anything that they might possibly have, this statement would be correct.

Representative Bolling. This is the reason I am concerned by the statement because it seems to me if I remember correctly that we have consistently when we got to the policy level—I am not talking about the intelligence level because I don't know much about that—underestimated the enemy's capabilities since the end of World War II.

Mr. McNeil. I don't think that is correct. I think that the intelligence estimates that are currently being presented to the committees in this Congress show just the opposite. Take their big bomber program we heard so much about 3 years ago. Did that come in as predicted? No, it didn't. I know that this is not the impression you frequently get from the press, radio commentators, and even from many Defense Department speeches. But I think cold analysis shows that we have often overestimated the actual strength of our opponents in our forward projections.

Representative Bolling. I know the argument on the big bomber. Let us take a couple of others. My memory is that we were wrong in our estimate of how quickly they would get the first so-called atomic weapons and how quickly they would get hydrogen weapons. I know these are generalized descriptions rather than accurate ones. It also seems to me that we perhaps have done somewhat the same thing in the missile field. I recognize that there was a great deal of alarm about about the size of their bomber program. It did not turn out that they were going to do it. I also recognize, or at least I think I do, that they made a deliberate decision which conceivably might have been the right one.

Mr. McNeil. For them.

Representative Bolling. Therefore, ICBM missiles rather than bombers. This is why I am very much concerned about a statement as broad and general as this.

Mr. McNeil. I think you have to read that in the time frame, and I should have added one phrase to show that it is the time frame covered by the purchase of equipment for this year. In the 1961 and 1962 peried that statement would be correct.

Representative Bolling. Thank you, Mr. Chairman, for the sake of the record, I would like to refer to——

Mr. McNeil. If I could add just one thing, Mr. Bolling. I think both in regard to the force levels, the type of equipment and the budgets, the United States does not necessarily have to match in numbers everything that an opponent might do, nor should he match everything we do. You mentioned a minute ago that he might very well have decided that he did not choose to go into the big bomber business. He preferred to put emphasis somewhere else. I think that is correct. I would guess that for him, it would be the smart thing to do. For us, we had the choice this year, within the present budget figure, of putting additional money into missiles or buying more bombers. It was a well-thought-out decision to proceed to buy additional heavy bombers with standoff air-to-ground missiles as well as supersonic medium bombers. It was decided that for us this was the right thing to do in the period immediately ahead.

The Russians have no carrier force. We happen to have a very powerful carrier force. I think you have to take into account all the different strings to our bow when we talk about our ability to stay free, to defend ourselves in the days to come, and not just dwell on one particular weapon system.

Representative Bolling. I heartily agree with that. The thing that disturbs me is history. In 1945, Russia was a very largely destroyed country. For a number of years we clearly had an enormous advantage, and an advantage based on the fact that only we had nuclear weapons. In the time since V–J Day it seems to me that they have made remarkable progress toward parity. The thing that concerns me is that if the rate of progress on our part and their part is plotted as a curve, it seems that they have been doing pretty well, I am not suggesting that we are not at the moment reasonably secure, because I don't know. But it does seem to me that based on the history of the last 14 years, they have done better relative to their start than we did relative to our start.

Mr. McNeil. Of course, during the 1945–49 period, we demobilized much more than they did. Then the question in 1950 was, how rapidly and to what extent should the United States build up its military strength. It was decided that a reasonably high level should be established and maintained so long as we are in trouble in the world, and that is one military policy that has been pretty well carried out since 1950. One may say that our military program should be a little bigger or a little smaller. But generally I think there is substantial agreement that within a small percentage we have been pretty much in the ball park.

There is no question that Russia has made gains, for example, on the economic side. They should. Of course, it does not bother us too much if they devote their growing economic strength to increasing their standard of living, and so forth. We have to remember also, that when they are going from zero up, the percentage figures work well in their favor. They are gaining. They are growing. When we come to the missile business, I don't know how you are going to stop them from having some real capability in the field.

Representative BOLLING. I don't anticipate that we will stop them from having real capability in many fields.

Mr. McNEIL. To see to it that they don't use them is our problem.

Representative BOLLING. The basic thing that concerns me is a very simple fact. We still today have an economy 2½ times as great as theirs despite their very rapid rate of increase, and one hears all over this Capitol and also this Nation that this economy which is 2½ times larger than theirs cannot afford to swamp them. I am not talking about just enough. I am talking about having so much more that there is no question whatever of our superiority.

Mr. McNEIL. I believe the general position of both the administration and the military is that we should have adequate defense and perhaps a decent margin above that.

Representative BOLLING. It is the margin that worries me. What is the decent margin?

Mr. McNEIL. We believe we have it now. Beyond that, if we are going to stay at this business for as long as we are in trouble in the world, we would probably be wiser to sustain that decent margin rather than to overdo it and run a chance of going back to the dangerous and costly peak or valley situation.

Representative BOLLING. I was much impressed a long time ago when I was a member of the Banking and Currency Committee when General Marshall testified that our defense effort over all our history looked like a fever chart. This makes a great deal of sense. My concern is that the level we choose be adequate to give us a decent margin.

Referring now to another subject for the record, on the 23d of January 1958, the Subcommittee on Fiscal Policy of this committee issued a report on the Federal expenditure policies for economic growth and stability. Its first three findings and conclusions in brief were, (1) that increasing the effectiveness of our national defense in the years ahead very likely will result in rising defense expenditures; (2) the prospect of higher levels of defense spending raises no serious questions about the capacity of the economy to meet these demands; (3) national defense requirements should guide rather than depend upon decisions concerning the level of composition of other Federal spending programs and the evaluation of revenue prospects and requirements.

My question is a very general one. Would it be safe to assume that the present defense budget was based on thinking along those lines?

Mr. McNEIL. Yes; pretty much. I think it is not quite as simple a problem as they might have put it, that is, in actually working it out. As I mentioned a minute ago, in response to Senator O'Mahoney, there is no question but that efforts to keep Federal income and outgo in some reasonable relationship, one to the other, put pressures on us to go through every program we have to see if something can be dropped without affecting those elements of our defense program that are truly essential to our security. We took out a number of programs this year. Maybe if there had not been any pressure to keep expenditures down a little bit we could have conceivably gone on with the Air Force Goose program. Conceivably work on the Regulus would have gone on for a few months longer. But I think that when all the budget discussions were finished we had a very sound program. While it is time that individual service chiefs probably would have liked a few more trucks here or a few more of this and that, and maybe a few more people, when they got all through they felt as a corporate body that all the essential requirements of the United States were taken care of by the budget we have sent forward. We must remember that this budget is only one increment in a long-range defense program involving the purchase of some $200 billion worth of equipment in the last 10 years.

Representative BOLLING. I don't have the quotation and I can't do it accurately, but I take it we are not to believe the words of Walter Lippmann in a column of a few days ago, that by a happy coincidence the amount of defense expenditure necessary for defense purposes is precisely the amount which enables us to have a balanced budget.

Mr. McNEIL. That is an easy statement to make and I heard it. I heard it all last fall, and I am not saying we did not take notice of the total budget problem in our discussions. However, I think if you look at the total Federal budget you will find that some other agencies of the Government were pressed pretty hard by the Director of the Budget and President to bring their spending down whereas in Defense we are slightly higher than in any previous year.

Representative BOLLING. You are slightly higher?

Mr. McNEIL. Yes.

Representative BOLLING. I thought in fiscal year 1954 the budget total was a billion one higher.

Mr. McNEIL. I really meant in recent years. When you go back to 1953 and 1954 fiscal years, you are in the middle of the Korean war, and you were partly financing the buildup from a very low level to what we call this rather high plateau that we have been on for several years.

Senator O'MAHONEY. In view of the answer of Mr. McNeil to Congressman Bolling's question, saying that the various departments and agencies of Government, excepting, I think, the Department of Defense, were subjected to severe pressure to keep expenditures down in order to possibly balance the budget, I should like to inquire what items there are in the President's budget for the development of antimissile missiles? The Russians have recently announced through the voice of one of their military leaders that they have missiles which no enemy can stop. Do we have any antimissile missile program?

Mr. McNEIL. Yes, but it is not ready for production.

Senator O'MAHONEY. It is not in the budget.

Mr. McNeil. We have money in the budget for everything that the scientific community believes can properly be spent on the rapid development of an antimissile missile. We have no money in the fiscal year 1960 budget for production bases and so forth, because the antimissile missile is not that far along.

Senator O'Mahoney. But you do have an antimissile missile program in mind?

Mr. McNeil. And a very big one.

Senator O'Mahoney. But it is not in the budget.

Mr. McNeil. It is in the budget; yes, indeed. It is in in a very substantial way. The only thing that is not in the budget is money for production and construction of sites. We are not buying land and launching sites for something we haven't got. We are trying to develop the missile, the computers and all the other things.

Senator O'Mahoney. You are in the beginning stages.

Mr. McNeil. Yes. This is the second year.

Senator O'Mahoney. The present budget covers only the beginning stages.

Mr. McNeil. The research and development stages—that is correct—because we have not got far enough along yet to build the system.

Senator O'Mahoney. If, before the end of this fiscal year, the scientists report developments that they have not yet made and it looks as though we ought to have antimissile missiles, we may be spending considerably more?

Mr. McNeil. We could be spending more. There could be a shift of emphasis, and we could be spending more. That is correct, either one.

Senator O'Mahoney. I don't think it is generally recognized by the public that the President's budget is just an estimate made in the latter part of 1958 for expenditures to be made during the period beginning July 1, 1959.

Mr. McNeil. It is an estimate. It is an estimate based on a plan.

Senator O'Mahoney. But it has a narrow margin of balance, $100 million.

Mr. McNeil. That is correct.

Senator O'Mahoney. Thank you.

The Chairman. Thank you very much, Mr. McNeil.

Before we break up, may I ask this question: Your staff submitted to our staff a series of statistical tables. Do I understand it would be proper for us to print these?

Mr. McNeil. All or any portion that are helpful to you.

The Chairman. Together with certain charts which you have prepared?

Mr. McNeil. Yes. All or any portion that might be helpful to your committee.

The Chairman. The staff of this committee requested that the Secretary furnish us obligations of the Department of Defense by quarters through fiscal 1960. Would that be possible?

Mr. McNeil. Yes; recognizing that for 1960 they will be our best estimate.

(The material referred to follows:)

DEPARTMENT OF DEFENSE

*Gross obligations for military functions, fiscal years 1958–60*

[Millions of dollars]

| | |
|---|---|
| Fiscal year 1958, total (actual) | 43,212 |
| 1st quarter, July–September 1957 | 8,059 |
| 2d quarter, October–December 1957 | 10,004 |
| 3d quarter, January–March 1958 | 10,987 |
| 4th quarter, April–June 1958 | 14,162 |
| Fiscal year 1959, total (estimate) | 46,042 |
| 1st quarter, July–September 1958 (actual) | 9,512 |
| 2d quarter, October–December 1958 (actual) | 11,904 |
| 3d quarter, January–March 1959 (estimated) | 11,905 |
| 4th quarter, April–June 1959 (estimated) | 12,721 |
| Fiscal year 1960, total (estimated)[1] | 44,420 |
| 1st half, July–December 1959 (estimated) | 21,000 |
| 2d half, January–June 1960 (estimated) | 23,420 |

[1] Fiscal year 1960 obligations exclude applicable portion (estimated at $800,000,000) of MAP orders to be issued from fiscal year 1960 military assistance appropriations.

NOTE.—Forecasts of obligations are inherently uncertain. This is especially true in the large dollar areas of procurement, construction, and research where an obligation can be recorded only upon signature of a contract (or its equivalent) which is the culmination of a time-consuming procedure involving the issuance of procurement directives, development of designs and specifications, calling for bids, etc. Since there is no way to determine the length of time required for each of the steps in the procurement and contracting procedure, there cannot be any element of precision in time phased predictions of obligations.

*Unliquidated balances of progress payments and advance payments compared with guaranteed loans outstanding, fiscal years 1957, 1958, and 1959*

[Millions of dollars]

| Fiscal year | Unliquidated balances of progress payments | Unliquidated balances of advance payments | Guaranteed loans outstanding | Fiscal year | Unliquidated balances of progress payments | Unliquidated balances of advance payments | Guaranteed loans outstanding |
|---|---|---|---|---|---|---|---|
| 1957—July | 4,280.8 | 33.0 | 344.2 | November | 4,075.1 | 48.7 | 353.2 |
| August | 3,885.6 | 29.5 | 330.9 | December | 3,897.0 | 43.9 | 351.3 |
| September | 3,888.8 | 29.4 | 349.3 | January | 3,789.1 | 52.9 | 332.5 |
| October | 3,929.9 | 35.3 | 343.4 | February | 3,709.8 | 48.5 | 322.2 |
| November | 3,930.9 | 29.6 | 354.3 | March | 3,625.2 | 45.2 | 315.6 |
| December | 3,816.8 | 44.0 | 367.7 | April | 3,481.3 | 54.7 | 292.9 |
| January | 3,853.7 | 46.1 | 378.4 | May | 3,440.1 | 51.1 | 275.3 |
| February | 3,957.2 | 42.8 | 375.9 | June | 3,297.4 | 44.5 | 276.2 |
| March | 3,915.8 | 39.5 | 385.8 | 1959—July | 3,237.9 | 47.1 | 247.7 |
| April | 4,025.4 | 54.8 | 377.4 | August | 3,214.6 | 48.6 | 246.0 |
| May | 4,103.1 | 49.4 | 379.4 | September | 2,860.9 | 48.4 | 245.1 |
| June | 4,045.5 | 40.2 | 383.4 | October | 2,733.2 | 51.7 | 251.6 |
| 1958—July | 4,037.6 | 55.2 | 378.5 | November | 2,626.7 | 48.1 | 251.1 |
| August | 4,102.9 | 53.6 | 354.8 | December (preliminary) | 2,640.9 | 46.9 | ([1]) |
| September | 4,070.4 | 46.9 | 358.4 | | | | |
| October | 4,056.1 | 57.8 | 360.0 | | | | |

[1] Not available.

Prepared by Economic and Fiscal Analysis Division, OASD (Comptroller).

*Department of Defense military and civilian personnel strengths, fiscal years 1959 and 1960* [1]

| | June 30, 1958 (actual) | Dec. 31, 1958 (actual) | June 30, 1959 (planned) | June 30, 1960 (planned) |
|---|---|---|---|---|
| Military personnel, total | 2,600,581 | 2,565,390 | 2,525,000 | 2,520,000 |
| Department of the Army | [2] 898,925 | [2] 890,769 | 870,000 | 870,000 |
| Department of the Navy | 830,500 | 821,947 | 805,000 | 805,000 |
| Navy | 641,005 | 634,270 | 630,000 | 630,000 |
| Marine Corps | 189,495 | 187,677 | 175,000 | 175,000 |
| Department of the Air Force | 871,156 | 852,674 | 850,000 | 845,000 |
| Civilian personnel (direct hire), total | 1,097,095 | 1,088,489 | 1,084,442 | 1,084,441 |
| Office of the Secretary of Defense | 1,646 | 1,656 | 1,756 | 1,756 |
| Department of the Army | 415,914 | 409,564 | 408,183 | 408,182 |
| Department of the Navy | 363,729 | 360,272 | 361,032 | 361,032 |
| Department of the Air Force | 315,806 | 316,997 | 313,471 | 313,471 |

[1] Preliminary.
[2] Includes reimbursables.

Prepared by Economic and Fiscal Analysis Division, OASD (comptroller).

*Department of Defense, military functions only—Percentage distribution of expenditures for major procurement and production by principal subcategories, fiscal years 1951–60*

| | Fiscal year— | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1951 [1] | 1952 [1] | 1953 [1] | 1954 [1] | 1955 [1] | 1956 [1] | 1957 [1] | 1958 [2] | 1959 [1] | 1960 [2] |
| Major procurement and production | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Aircraft | 60.7 | 42.6 | 43.3 | 52.2 | 61.8 | 58.7 | 58.5 | 57.6 | 50.0 | 45.1 |
| Missiles | .5 | 1.5 | 1.7 | 3.2 | 5.5 | 9.6 | 15.3 | 18.6 | 23.6 | 26.9 |
| Ships and harbor craft | 9.6 | 5.4 | 7.0 | 6.8 | 7.8 | 7.3 | 6.6 | 7.9 | 10.0 | 11.3 |
| Combat and support vehicles | 6.2 | 16.7 | 13.6 | 5.7 | 8.0 | 2.0 | 2.8 | 1.5 | 1.6 | 1.8 |
| Ammunition | 10.1 | 11.5 | 13.7 | 17.1 | 5.1 | 11.3 | 3.5 | 2.2 | 2.3 | 1.8 |
| Electronics and communications | 4.9 | 5.2 | 5.8 | 5.2 | 4.9 | 6.3 | 6.5 | 6.0 | 5.2 | 7.2 |
| Production equipment and facilities | 1.9 | 8.8 | 9.7 | 7.0 | 4.9 | 3.6 | 3.4 | 3.1 | 2.5 | 1.9 |
| Other | 6.2 | 8.3 | 5.2 | 2.7 | 2.0 | 1.2 | 3.5 | 3.1 | 4.8 | 4.0 |

[1] Actual.
[2] Estimated.

Source: OSD Comptroller, EFAD-220, Jan. 19, 1959.

*Average monthly defense expenditures for selected budget categories compared with average monthly employment in selected defense-related industries, fiscal years 1951–58*

[Millions of dollars, thousands of employees]

| Fiscal year | Expenditures for aircraft and guided missiles | Employment in aircraft and parts | Expenditures for ships and harbor craft | Employment in ship and boat building and repairing | Expenditures for electronics and communications | Employment in communications equipment | Expenditures for combat vehicles, artillery, weapons and ammunition | Employment in ordnance |
|---|---|---|---|---|---|---|---|---|
| 1951 | $203 | 358.1 | $31.8 | 99.7 | $16.1 | 394.7 | $52.9 | 42.3 |
| 1952 | 421 | 565.0 | 52.0 | 135.2 | 49.8 | 425.3 | 224.2 | 131.7 |
| 1953 | 643 | 740.2 | 99.3 | 157.6 | 83.4 | 533.1 | 383.6 | 214.8 |
| 1954 | 737 | 782.3 | 90.8 | 143.8 | 68.8 | 518.0 | 287.8 | 206.7 |
| 1955 | 730 | 742.1 | 84.1 | 122.8 | 53.0 | 494.4 | 111.2 | 145.7 |
| 1956 | 693 | 761.8 | 74.6 | 124.5 | 64.2 | 540.0 | 107.6 | 133.0 |
| 1957 | 839 | 863.9 | 74.8 | 140.0 | 73.4 | 570.6 | 63.4 | 133.2 |
| 1958 | 932 | 795.3 | 96.3 | 148.2 | 72.9 | 563.4 | 32.6 | 123.6 |

NOTE.—Defense expenditure categories are not completely comparable with the BLS industry categories. For example, Department of Defense expenditures for aircraft and missiles contain substantial amounts for electronic components manufactured by the electronics industry. Conversely, the BLS classifies individual firms on a major-product basis which may result in the concealment or understatement of employment in other important activities with a simultaneous overstatement of employment in the major activity. Also, defense expenditures exclude the military assistance program.

Source: Bureau of Labor Statistics, Monthly Labor Review; OSD Comptroller, EFAD-220.
Prepared by the Economic and Fiscal Analysis Division, OASD (Comptroller), Department of Defense

*Department of Defense obligations (orders) for hard goods compared with new orders, unfilled orders, and inventories in the durable goods industries*

[Millions of dollars]

| Fiscal year | Department of Defense obligations for hard goods | Durable goods industries: New orders received | Unfilled orders: End of quarter | Unfilled orders: Changes from previous quarter | Inventories: End of quarter | Inventories: Changes from previous quarter |
|---|---|---|---|---|---|---|
| 1951—Total | 26,054 | 154,503 | | | | |
| 1st quarter | 4,221 | 35,916 | 28,070 | | 14,928 | |
| 2d quarter | 4,481 | 34,171 | 32,190 | +4,120 | 16,768 | +1,840 |
| 3d quarter | 8,884 | 45,117 | 50,230 | +18,040 | 18,250 | +1,482 |
| 4th quarter | 8,468 | 39,299 | 57,348 | +7,118 | 20,171 | +1,921 |
| 1952—Total | 33,027 | 138,659 | | | | |
| 1st quarter | 6,770 | 33,754 | 61,883 | +4,535 | 21,569 | +1,398 |
| 2d quarter | 6,341 | 33,922 | 64,141 | +2,258 | 22,815 | +1,246 |
| 3d quarter | 7,927 | 35,323 | 67,813 | +3,672 | 23,944 | +1,129 |
| 4th quarter | 11,989 | 35,657 | 71,367 | +3,554 | 23,813 | −131 |
| 1953—Total | 21,119 | 144,164 | | | | |
| 1st quarter | 9,292 | 34,570 | 75,113 | +3,746 | 23,403 | −410 |
| 2d quarter | 4,013 | 34,700 | 73,176 | −1,937 | 24,428 | +1,025 |
| 3d quarter | 4,646 | 37,888 | 73,580 | +404 | 25,456 | +1,028 |
| 4th quarter | 3,168 | 37,006 | 71,237 | −2,343 | 26,083 | +627 |
| 1954—Total | 5,604 | 116,099 | | | | |
| 1st quarter | 751 | 30,241 | 64,681 | −6,556 | 26,194 | +111 |
| 2d quarter | 362 | 27,254 | 57,060 | −7,621 | 26,272 | +78 |
| 3d quarter | 1,179 | 29,129 | 52,138 | −4,922 | 25,633 | −639 |
| 4th quarter | 3,310 | 29,475 | 46,936 | −5,202 | 24,607 | −1,026 |

***Department of Defense obligations (orders) for hard goods compared with new orders, unfilled orders, and inventories in the durable goods industries*—Con.**

[Millions of dollars]

| Fiscal year | Department of Defense obligations for hard goods | Durable goods industries: New orders received | Unfilled orders: End of quarter | Unfilled orders: Changes from previous quarter | Inventories: End of quarter | Inventories: Changes from previous quarter |
|---|---|---|---|---|---|---|
| 1955—Total | 11,036 | 143,031 | | | | |
| 1st quarter | 2,341 | 30,152 | 44,999 | −1,937 | 23,449 | −1,158 |
| 2d quarter | 4,528 | 33,112 | 44,081 | −918 | 24,133 | +684 |
| 3d quarter | 1,720 | 39,016 | 46,091 | +2,010 | 24,197 | +64 |
| 4th quarter | 2,448 | 40,751 | 46,622 | +531 | 24,426 | +229 |
| 1956—Total | 14,113 | 173,838 | | | | |
| 1st quarter | 660 | 41,519 | 49,659 | +3,037 | 25,375 | +949 |
| 2d quarter | 3,099 | 44,947 | 53,372 | +3,713 | 26,664 | +1,289 |
| 3d quarter | 4,454 | 43,035 | 55,648 | +2,276 | 27,868 | +1,204 |
| 4th quarter | 5,901 | 44,337 | 57,334 | +1,686 | 28,760 | +892 |
| 1957—Total | 15,138 | 169,681 | | | | |
| 1st quarter | 3,851 | 41,632 | 60,487 | +3,153 | 29,451 | +691 |
| 2d quarter | 4,183 | 44,338 | 61,015 | +528 | 30,660 | +1,209 |
| 3d quarter | 3,707 | 42,697 | 60,341 | −674 | 31,512 | +852 |
| 4th quarter | 3,397 | 41,014 | 57,164 | −3,177 | 31,749 | +237 |
| 1958—Total | 17,483 | 141,358 | | | | |
| 1st quarter | 2,249 | 37,246 | 53,179 | −3,985 | 31,306 | −443 |
| 2d quarter | 4,024 | 36,063 | 48,127 | −5,052 | 31,137 | −169 |
| 3d quarter | 4,784 | 32,957 | 45,059 | −3,068 | 30,168 | −969 |
| 4th quarter | 6,426 | 35,092 | 43,686 | −1,373 | 28,698 | −1,470 |
| 1959—Total, 1st quarter (preliminary) | 2,575 | 35,775 | 43,577 | −109 | 27,745 | −953 |

NOTE.—The term "hard goods" as used in the Department of Defense includes (1) major items of equipment such as aircraft, missiles, ships, tanks, vehicles, ammunition, weapons, artillery, electronics, communications, etc.; (2) maintenance spares and spare parts for such equipment; and (3) organizational equipment and supplies. It excludes subsistence, petroleum products, and clothing. Amounts will not necessarily add to totals due to rounding.

Source: Obligations for hard goods quarterly figures for fiscal years 1951–53 are estimated; annual figures for fiscal years 1951–53 and all figures for fiscal years 1954–59 are from the Department of Defense: Monthly Report on the Status of Funds by Budget Category. Durable-goods industries series (unadjausted) are from Survey of Current Business.

Prepared by Economic and Fiscal Analysis Division, OASD (Comptroller).

*Department of Defense net expenditures for hard goods compared with sales, changes in unfilled orders, and inventories in the durable-goods industries*

[Millions of dollars]

| Fiscal year | Department of Defense net expenditures for hard goods | Durable-goods industries: Sales | Durable-goods industries: Quarterly changes in unfilled orders | Durable-goods industries: Quarterly changes in inventories |
|---|---|---|---|---|
| 1951—Total | 5,443 | 122,022 | | |
| 1st quarter | 870 | 28,212 | | |
| 2d quarter | 980 | 30,192 | +4,120 | +1,840 |
| 3d quarter | 1,524 | 31,437 | +18,040 | +1,482 |
| 4th quarter | 2,069 | 32,181 | +7,118 | +1,921 |
| 1952—Total | 15,505 | 124,640 | | |
| 1st quarter | 2,635 | 29,222 | +4,535 | +1,398 |
| 2d quarter | 3,259 | 31,664 | +2,258 | +1,246 |
| 3d quarter | 4,186 | 31,651 | +3,672 | +1,129 |
| 4th quarter | 5,428 | 32,103 | +3,554 | −131 |
| 1953—Total | 20,180 | 144,294 | | |
| 1st quarter | 4,036 | 30,824 | +3,746 | −410 |
| 2d quarter | 5,045 | 36,637 | −1,937 | +1,025 |
| 3d quarter | 5,045 | 37,484 | +404 | +1,028 |
| 4th quarter | 6,054 | 39,349 | −2,343 | +627 |
| 1954—Total | 18,232 | 140,400 | | |
| 1st quarter | 4,739 | 36,617 | −6,556 | +111 |
| 2d quarter | 4,632 | 35,055 | −7,621 | +78 |
| 3d quarter | 4,703 | 34,051 | −4,922 | −639 |
| 4th quarter | 4,156 | 34,677 | −5,202 | −1,026 |
| 1955—Total | 14,182 | 142,835 | | |
| 1st quarter | 3,228 | 31,579 | −1,937 | −1,158 |
| 2d quarter | 3,658 | 34,030 | −918 | +684 |
| 3d quarter | 3,818 | 37,006 | +2,010 | +64 |
| 4th quarter | 3,478 | 40,220 | +531 | +229 |
| 1956—Total | 13,201 | 163,092 | | |
| 1st quarter | 3,415 | 38,482 | +3,037 | +949 |
| 2d quarter | 3,107 | 41,234 | +3,713 | +1,289 |
| 3d quarter | 3,108 | 40,759 | +2,276 | +1,204 |
| 4th quarter | 3,572 | 42,617 | +1,686 | +892 |
| 1957—Total | 14,573 | 169,851 | | |
| 1st quarter | 2,824 | 38,479 | +3,153 | +691 |
| 2d quarter | 3,802 | 43,810 | +528 | +1,209 |
| 3d quarter | 3,836 | 43,371 | −674 | +852 |
| 4th quarter | 4,112 | 44,191 | −3,177 | +237 |
| 1958—Total | 15,281 | 154,845 | | |
| 1st quarter | 3,684 | 41,231 | −3,985 | −443 |
| 2d quarter | 3,737 | 41,115 | −5,052 | −169 |
| 3d quarter | 3,698 | 36,034 | −3,068 | −969 |
| 4th quarter | 4,165 | 36,465 | −1,373 | −1,470 |
| 1959—Total, 1st quarter | 3,501 | 35,884 | −109 | −953 |

NOTE.—The term "hard goods" as used in the Department of Defense includes (1) major items of equipment such as aircraft, missiles, ships, tanks, vehicles, ammunition, weapons, artillery, electronics, and communications, etc., (2) maintenance spares and spare parts for such equipment, and (3) organizational equipment and supplies. It excludes subsistence, petroleum products, and clothing.

Amounts will not necessarily add to totals due to rounding.

Source: Net expenditures for hard goods quarterly figures for fiscal years 1951–53 are estimated; annual figures for fiscal years 1951–53 and all figures for fiscal years 1954–59 are from the Department of Defense: Monthly Report on Status of Funds by Budget Category. Durable goods industries (unadjusted) are from the Survey of Current Business.

Prepared by Economic and Fiscal Analysis Division, OASD (Comptroller).

## Department of Defense Guaranteed Loan Program

### *Financial position of program*

| | Department of Defense | Army | Navy | Air Force |
|---|---|---|---|---|
| Assets: | | | | |
| Cash | $17,765,402.20 | $2,461,802.13 | $8,808,275.59 | $6,495,324.48 |
| Purchased loans receivable, current | 5,191,260.88 | | | 5,191,260.88 |
| Purchased loans receivable, past due | 2,898,695.81 | 2,753,844.08 | 144,851.73 | |
| Purchased interest receivable, current | | | | |
| Purchased interest receivable, past due | 384.90 | | 384.90 | |
| Collection costs receivable | | | | |
| Total assets | 25,855,743.79 | 5,215,646.21 | 8,953,512.22 | 11,686,585.36 |
| Less liabilities: Advances from appropriations | | | | |
| Retained income | 25,855,743.79 | 5,215,646.21 | 8,953,512.22 | 11,686,585.36 |

### *Income and expenses from July 1, 1950, to date*

| | Department of Defense | Army | Navy | Air Force |
|---|---|---|---|---|
| Income: | | | | |
| Guarantee fees, interest | $26,065,611.35 | $5,816,703.04 | $8,277,647.20 | $11,971,261.10 |
| Guarantee fees, commitment fees | 1,282,749.67 | 347,022.09 | 376,649.88 | 559,077.71 |
| Interest income on purchased loans | 1,700,551.21 | 405,691.49 | 1,057,503.39 | 237,356.33 |
| Total income | 29,048,912.23 | 6,569,416.62 | 9,711,800.47 | 12,767,695.14 |
| Expenses: | | | | |
| Administrative costs, fiscal agents | 3,014,470.96 | 1,184,526.34 | 753,083.12 | 1,076,861.50 |
| Other expenses | 8,106.20 | 1,952.46 | 1,905.46 | 4,248.28 |
| Loss on purchased loans charged off | 170,591.28 | 167,291.61 | 3,299.67 | |
| Total expenses | 3,193,168.44 | 1,353,770.41 | 758,288.25 | 1,081,109.78 |
| Net income | 25,855,743.79 | 5,215,646.21 | 8,953,512.22 | 11,686,585.36 |

### *Status of purchased loans* [1]

| | Department of Defense | Army | Navy | Air Force |
|---|---|---|---|---|
| Guarantees purchased | 53 | 31 | 18 | 4 |
| Principal | $49,917,124.80 | $15,740,894.83 | $26,913,522.64 | $7,262,707.33 |
| Interest | 159,323.43 | 64,413.79 | 43,549.27 | 51,360.37 |
| Collection costs | 1,787.73 | 1,787.73 | | |
| Total | 50,078,235.96 | 15,807,096.35 | 26,957,071.91 | 7,314,067.70 |
| Less amount liquidated | 41,817,303.09 | 12,885,960.66 | 26,808,535.61 | 2,122,806.82 |
| Less loans charged off | 170,591.28 | 167,291.61 | 3,299.67 | |
| Balance due | 8,090,341.59 | 2,753,844.08 | 145,236.63 | 5,191,260.88 |
| Estimated amount uncollectible | 2,039,952.08 | 2,025,755.00 | 14,197.08 | |

[1] Amounts include 15 Army and 14 Navy loans liquidated in full. Also 6 Army and 1 Navy loan determined as uncollectible and written off as losses.

### *Status of guaranteed loan applications*

[Dollar amounts in millions]

| Item | Department of Defense | | | Army | | |
|---|---|---|---|---|---|---|
| | Number | Loan value | Amount of guarantee | Number | Loan value | Amount of guarantee |
| As of Dec. 31, 1958: | | | | | | |
| Applications received since July 1, 1950 | 1,777 | $3,039.5 | $2,437.8 | 845 | $928.5 | $749.4 |
| Applications authorized | 1,524 | 2,954.8 | 2,362.2 | 690 | 879.7 | 706.0 |
| Applications declined | 248 | 83.6 | 74.8 | 154 | 48.5 | 43.1 |
| Applications pending | 5 | 1.1 | .8 | 1 | .3 | .2 |
| 10 days and under | 1 | | | | | |
| 11 to 20 days | 2 | | | 1 | | |
| 21 to 30 days | 1 | | | | | |
| 31 to 40 days | 1 | | | | | |
| 41 to 50 days | | | | | | |
| Over 50 days | | | | | | |
| As of Nov. 30, 1958: | | | | | | |
| Applications pending | 4 | | | 1 | | |
| Outstanding loan guarantees | 124 | 433.2 | 309.1 | 27 | 24.2 | 18.9 |
| Less credit outstanding | 115 | 251.1 | 181.3 | 26 | 15.7 | 12.5 |
| Additional credit available | | 182.1 | 127.9 | | 8.5 | 6.4 |

| Item | Navy | | | Air Force | | |
|---|---|---|---|---|---|---|
| | Number | Loan value | Amount of guarantee | Number | Loan value | Amount of guarantee |
| As of Dec. 31, 1958: | | | | | | |
| Applications received since July 1, 1950 | 415 | $718.6 | $589.6 | 517 | $1,392.3 | $1,098.9 |
| Applications authorized | 363 | 696.4 | 569.3 | 471 | 1,378.6 | 1,087.0 |
| Applications declined | 50 | 21.9 | 20.0 | 44 | 13.2 | 11.6 |
| Applications pending | 2 | .3 | .2 | 2 | .5 | .3 |
| 10 days and under | 1 | | | | | |
| 11 to 20 days | | | | 1 | | |
| 21 to 30 days | | | | 1 | | |
| 31 to 40 days | 1 | | | | | |
| 41 to 50 days | | | | | | |
| Over 50 days | | | | | | |
| As of Nov. 30, 1958: | | | | | | |
| Applications pending | 1 | | | 2 | | |
| Outstanding loan guarantees | 30 | 182.9 | 123.9 | 67 | 226.1 | 166.4 |
| Less credit outstanding | 28 | 99.9 | 68.7 | 61 | 135.5 | 100.1 |
| Additional credit available | | 83.0 | 55.1 | | 90.6 | 66.3 |

NOTE.—Amounts will not necessarily add to totals due to rounding.

*Applications authorized, by size of loan*

| | Department of Defense | | Army | Navy | Air Force |
|---|---|---|---|---|---|
| | Number | Percent | | | |
| Applications authorized since July 1, 1950 | 1,524 | 100 | 690 | 363 | 471 |
| $10,000 and under | 11 | 1 | 3 | 2 | 6 |
| $10,001 to $25,000 | 38 | 2 | 15 | 13 | 10 |
| $25,001 to $50,000 | 89 | 6 | 44 | 17 | 28 |
| $50,001 to $100,000 | 180 | 12 21 | 90 | 40 | 50 |
| $100,001 to $300,000 | 371 | 24 | 178 | 94 | 99 |
| $300,001 to $500,000 | 226 | 15 60 | 113 | 54 | 59 |
| $500,001 to $1,000,000 | 211 | 14 74 | 98 | 49 | 64 |
| $1,000,001 to $2,500,000 | 204 | 13 | 86 | 46 | 72 |
| $2,500,001 to $5,000,000 | 104 | 7 94 | 37 | 24 | 43 |
| $5,000,001 to $10,000,000 | 43 | 3 | 13 | 12 | 18 |
| $10,000,001 to $15,000,000 | 17 | 1 | 6 | 4 | 7 |
| $15,000,001 to $50,000,000 | 27 | 2 | 6 | 7 | 14 |
| Over $50,000,000 | 3 | (1) | 1 | 1 | 1 |
| Average percent guarantee authorized (by amount) | 80.3 | ---------- | 80.3 | 81.7 | 78.8 |

(1) Less than 0.5 percent.

*Applications authorized, by percent of guarantee*

| | Department of Defense | | Army | Navy | Air Force |
|---|---|---|---|---|---|
| | Number | Percent | | | |
| Applications authorized | 1,524 | 100 | 690 | 363 | 471 |
| 100 percent | 22 | 1 | 8 | 13 | 1 |
| 95 percent | 42 | 3 | 30 | 12 | ---------- |
| 90 percent | 768 | 50 | 340 | 174 | 254 |
| 85 percent | 96 | 6 | 50 | 20 | 26 |
| 80 percent | 264 | 17 | 118 | 67 | 79 |
| 75 percent | 98 | 6 | 40 | 21 | 37 |
| 70 percent | 215 | 14 | 97 | 50 | 68 |
| 65 percent | 2 | (1) | 1 | ---------- | 1 |
| 60 percent and under | 17 | 1 | 6 | 6 | 5 |

(1) Less than 0.5 percent.

## DATA ON BUDGET CATEGORY BASIS

Data for the years prior to fiscal year 1958 are not available on a basis comparable to the budget structure proposed for fiscal year 1960. Accordingly, the attached tables on the old budget category basis are distributed solely to provide fiscal data for comparative purposes.

## DEPARTMENT OF DEFENSE

*New obligational authority, direct obligations and expenditures, by major budget category, fiscal years 1958–60*

[Millions of dollars]

| Budget category | New obligational authority | | | Direct obligations | | | Expenditures | | |
|---|---|---|---|---|---|---|---|---|---|
| | Fiscal year 1958 | Fiscal year 1959 | Fiscal year 1960 | Fiscal year 1958 | Fiscal year 1959 | Fiscal year 1960 | Fiscal year 1958 | Fiscal year 1959 | Fiscal year 1960 |
| Operating costs | $21,892 | $22,366 | $22,546 | $21,884 | $22,349 | $22,561 | $21,673 | $22,462 | $22,432 |
| Military personnel | 10,398 | 10,720 | 10,642 | 10,386 | 10,666 | 10,642 | 10,440 | 10,636 | 10,617 |
| Reserve components | 1,204 | 1,183 | 1,153 | 1,172 | 1,207 | 1,162 | 1,185 | 1,204 | 1,164 |
| Operation and maintenance | 9,369 | 9,436 | 9,633 | 9,424 | 9,438 | 9,639 | 9,113 | 9,570 | 9,542 |
| Establishmentwide activities | 921 | 1,027 | 1,118 | 902 | 1,038 | 1,118 | 935 | 1,052 | 1,109 |
| Retired pay | (567) | (645) | (715) | (561) | (645) | (715) | (562) | (645) | (715) |
| Other | (354) | (382) | (403) | (341) | (393) | (403) | (373) | (407) | (394) |
| Capital costs | 15,315 | 19,306 | 18,615 | 19,157 | 21,086 | 20,147 | 18,112 | 18,578 | 18,849 |
| Major procurement and production | 11,399 | 15,325 | 14,398 | 15,755 | 16,459 | 15,914 | 14,677 | 14,234 | 14,596 |
| Aircraft | (5,726) | (6,345) | (6,353) | (8,237) | (7,451) | (6,948) | (8,448) | (7,117) | (6,589) |
| Missiles | (2,313) | (4,345) | (3,961) | (3,391) | (4,347) | (4,126) | (2,737) | (3,360) | (3,922) |
| Ships | (1,781) | (1,977) | (1,343) | (1,760) | (1,931) | (1,721) | (1,156) | (1,418) | (1,643) |
| Other | (1,580) | (2,658) | (2,742) | (2,366) | (2,730) | (3,118) | (2,336) | (2,340) | (2,441) |
| Research and development | 1,912 | 2,639 | 2,711 | 1,847 | 2,702 | 2,711 | 1,742 | 2,355 | 2,594 |
| Military construction | 2,004 | 1,342 | 1,506 | 1,556 | 1,925 | 1,523 | 1,693 | 1,988 | 1,660 |
| Working capital funds | 130 | | 30 | | | | −723 | −240 | −336 |
| Subtotal | 37,337 | 41,673 | 41,190 | 41,042 | 43,435 | 42,707 | 39,062 | 40,800 | 40,945 |
| Available by transfer | −590 | −535 | −340 | | | | | | |
| Total | 36,747 | 41,138 | 40,850 | 41,042 | 43,435 | 42,707 | 39,062 | 40,800 | 40,945 |

NOTE.—Includes proposed fiscal year 1959 supplemental of $294.2 million.

36379—59——46

## Department of Defense, Military Functions

*Fiscal year 1960 budget summary, by major budget category*

[Millions of dollars]

| Budget category | New obligational authority | | | | | Direct obligations | | | | | Net expenditures | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Total | Army | Navy | Air Force | OSD | Total | Army | Navy | Air Force | OSD | Total | Army | Navy | Air Force | OSD |
| I. Military personnel costs | 10,642 | 3,514 | 3,164 | 3,964 | | 10,642 | 3,514 | 3,164 | 3,964 | | 10,617 | 3,506 | 3,152 | 3,959 | |
| II. Operation and maintenance | 9,633 | 2,714 | 2,645 | 4,274 | | 9,639 | 2,720 | 2,645 | 4,274 | | 9,542 | 2,746 | 2,605 | 4,191 | |
| III. Major procurement and production | 14,398 | 1,468 | 4,374 | 8,555 | | 15,914 | 1,811 | 4,971 | 9,131 | | 14,596 | 1,520 | 4,595 | 8,480 | 1 |
| Aircraft | 6,353 | 70 | 1,725 | 4,558 | | 6,948 | 91 | 1,866 | 4,991 | | 6,589 | 143 | 1,778 | 4,669 | |
| Missiles | 3,961 | 634 | 703 | 2,624 | | 4,126 | 738 | 716 | 2,672 | | 3,922 | 695 | 566 | 2,661 | |
| Ships | 1,343 | 5 | 1,338 | | | 1,721 | 6 | 1,715 | (1) | | 1,643 | 3 | 1,640 | (1) | 1 |
| Other | 2,742 | 760 | 609 | 1,373 | | 3,118 | 976 | 674 | 1,468 | | 2,441 | 679 | 611 | 1,150 | |
| IV. Military construction | 1,506 | 341 | 244 | 898 | 23 | 1,523 | 336 | 266 | 898 | 23 | 1,660 | 267 | 305 | 1,043 | 45 |
| V. Reserve components | 1,153 | 648 | 217 | 288 | | 1,162 | 655 | 219 | 288 | | 1,164 | 650 | 215 | 299 | |
| Reserve construction | 57 | 31 | 9 | 17 | | 66 | 38 | 11 | 17 | | 62 | 37 | 10 | 15 | |
| Other | 1,096 | 617 | 208 | 271 | | 1,096 | 617 | 208 | 271 | | 1,101 | 613 | 205 | 284 | |
| VI. Research and development | 2,711 | 573 | 783 | 750 | 605 | 2,711 | 573 | 783 | 750 | 605 | 2,594 | 547 | 779 | 725 | 543 |
| VII. Establishmentwide activities | 1,118 | 298 | 34 | 3 | 783 | 1,118 | 298 | 34 | 3 | 783 | 1,109 | 294 | 33 | 3 | 780 |
| Retired pay | 715 | | | | 715 | 715 | | | | 715 | 715 | | | | 715 |
| Other | 403 | 298 | 34 | 3 | 68 | 403 | 298 | 34 | 3 | 68 | 394 | 294 | 33 | 3 | 65 |
| VIII. Working capital (revolving) funds | 30 | | | | 30 | | | | | | −336 | −226 | −87 | −25 | 42 |
| Total | 41,190 | 9,557 | 11,460 | 18,732 | 1,441 | 42,707 | 9,907 | 12,081 | 19,308 | 1,411 | 40,945 | 9,264 | 11,596 | 18,675 | 1,410 |
| Available by transfer | −340 | −200 | −90 | −50 | | | | | | | | | | | |
| Total, new obligational authority | 40,850 | 9,357 | 11,370 | 18,682 | 1,441 | | | | | | | | | | |

[1] Less than $0.5 million.

*Fiscal year 1959 budget summary, by major budget category*

[Millions of dollars]

| Budget category | New obligational authority | | | | | Direct obligations | | | | | Net expenditures | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Total | Army | Navy | Air Force | OSD | Total | Army | Navy | Air Force | OSD | Total | Army | Navy | Air Force | OSD |
| I. Military personnel costs | 10,720 | 3,551 | 3,218 | 3,951 | ------- | 10,666 | 3,525 | 3,190 | 3,951 | ------- | 10,636 | 3,519 | 3,168 | 3,949 | ------- |
| II. Operation and maintenance | 9,436 | 2,770 | 2,544 | 4,123 | ------- | 9,438 | 2,758 | 2,557 | 4,123 | ------- | 9,570 | 2,774 | 2,583 | 4,213 | ------- |
| III. Major procurement and production | 15,325 | 1,693 | 4,822 | 8,810 | ------- | 16,459 | 1,656 | 5,340 | 9,460 | 3 | 14,234 | 1,303 | 4,369 | 8,560 | 3 |
| Aircraft | 6,345 | 130 | 1,680 | 4,535 | ------- | 7,451 | 143 | 2,004 | 5,304 | ------- | 7,117 | 115 | 1,972 | 5,030 | ------- |
| Missiles | 4,345 | 672 | 735 | 2,938 | ------- | 4,347 | 913 | 720 | 2,714 | ------- | 3,360 | 587 | 417 | 2,356 | ------- |
| Ships | 1,977 | ------- | 1,977 | ------- | ------- | 1,931 | 3 | 1,925 | ------- | 3 | 1,418 | 2 | 1,413 | [1] | 3 |
| Other | 2,658 | 891 | 430 | 1,337 | ------- | 2,730 | 597 | 690 | 1,442 | ------- | 2,340 | 599 | 567 | 1,174 | ------- |
| IV. Military construction | 1,342 | 230 | 295 | 785 | 32 | 1,925 | 250 | 343 | 1,300 | 32 | 1,988 | 345 | 393 | 1,200 | 50 |
| V. Reserve components | 1,183 | 662 | 215 | 306 | ------- | 1,207 | 682 | 223 | 302 | ------- | 1,204 | 680 | 223 | 301 | ------- |
| Reserve construction | 26 | 6 | 8 | 12 | ------- | 66 | 38 | 15 | 13 | ------- | 88 | 41 | 15 | 32 | ------- |
| Other | 1,157 | 656 | 207 | 294 | ------- | 1,141 | 644 | 208 | 289 | ------- | 1,116 | 639 | 208 | 269 | ------- |
| VI. Research and development | 2,639 | 532 | 831 | 740 | 536 | 2,702 | 554 | 827 | 758 | 563 | 2,355 | 519 | 716 | 755 | 365 |
| VII. Establishmentwide activities | 1,027 | 280 | 32 | 3 | 711 | 1,038 | 293 | 31 | 3 | 711 | 1,052 | 301 | 31 | 11 | 709 |
| Retired pay | 645 | ------- | ------- | ------- | 645 | 645 | ------- | ------- | ------- | 645 | 645 | ------- | ------- | ------- | 645 |
| Other | 382 | 280 | 32 | 3 | 66 | 393 | 293 | 31 | 3 | 66 | 407 | 301 | 31 | 11 | 64 |
| VIII. Working capital (revolving funds) | ------- | ------- | ------- | ------- | ------- | ------- | ------- | ------- | ------- | ------- | −240 | −275 | −10 | 4 | 42 |
| Total | 41,673 | 9,718 | 11,958 | 18,717 | 1,279 | 43,435 | 9,719 | 12,510 | 19,896 | 1,310 | 40,800 | 9,165 | 11,472 | 18,993 | 1,170 |
| Available by transfer | −535 | −375 | −160 | ------- | ------- | ------- | ------- | ------- | ------- | ------- | ------- | ------- | ------- | ------- | ------- |
| Total, new obligational authority | 41,138 | 9,343 | 11,798 | 18,717 | 1,279 | ------- | ------- | ------- | ------- | ------- | ------- | ------- | ------- | ------- | ------- |

[1] Less than $0.5 million.

NOTE.—Includes proposed fiscal year 1959 supplemental of $294.2 million:

| | *Million* |
|---|---|
| Army | $51.7 |
| Navy | 127.6 |
| Air Force | 108.8 |
| OSD | 6.1 |

*Fiscal year 1958 budget summary, by major budget category*

[Millions of dollars]

| Budget category | New obligational authority | | | | | Direct obligations | | | | | Net expenditures | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Total | Army | Navy | Air Force | OSD | Total | Army | Navy | Air Force | OSD | Total | Army | Navy | Air Force | OSD |
| I. Military personnel costs | 10,398 | 3,489 | 3,094 | 3,815 | | 10,386 | 3,489 | 3,083 | 3,815 | | 10,440 | 3,541 | 3,082 | 3,817 | |
| II. Operation and maintenance | 9,369 | 2,813 | 2,537 | 4,019 | | 9,424 | 2,887 | 2,537 | 4,000 | | 9,113 | 2,831 | 2,494 | 3,788 | |
| III. Major procurement and production | 11,399 | 20 | 4,000 | 7,379 | | 15,755 | 1,553 | 4,772 | 9,426 | 5 | 14,677 | 1,505 | 4,233 | 8,925 | 15 |
| Aircraft | 5,726 | | 1,536 | 4,190 | | 8,237 | 100 | 2,111 | 6,026 | | 8,448 | 157 | 2,207 | 6,084 | |
| Missiles | 2,313 | 20 | 402 | 1,890 | | 3,391 | 718 | 442 | 2,231 | | 2,737 | 724 | 335 | 1,668 | |
| Ships | 1,781 | | 1,781 | | | 1,760 | (1) | 1,755 | (1) | 5 | 1,156 | 3 | 1,138 | (1) | 15 |
| Other | 1,580 | | 281 | 1,299 | | 2,366 | 734 | 464 | 1,168 | | 2,336 | 621 | 532 | 1,173 | |
| IV. Military construction | 2,004 | 310 | 265 | 1,420 | 9 | 1,556 | 356 | 304 | 884 | 12 | 1,693 | 343 | 406 | 928 | 16 |
| V. Reserve components | 1,204 | 700 | 198 | 306 | | 1,172 | 666 | 202 | 305 | | 1,185 | 668 | 220 | 297 | |
| Reserve construction | 74 | 55 | | 19 | | 77 | 39 | 13 | 25 | | 97 | 42 | 19 | 37 | |
| Other | 1,130 | 645 | 198 | 287 | | 1,096 | 627 | 189 | 280 | | 1,087 | 626 | 201 | 261 | |
| VI. Research and development | 1,912 | 506 | 573 | 715 | 117 | 1,847 | 492 | 586 | 719 | 50 | 1,742 | 476 | 569 | 694 | 3 |
| VII. Establishmentwide activities | 921 | 294 | 28 | 3 | 596 | 902 | 282 | 27 | 2 | 590 | 935 | 271 | 27 | 40 | 596 |
| Retired pay | 567 | | | | 567 | 561 | | | | 561 | 562 | | | | 562 |
| Other | 354 | 294 | 28 | 3 | 29 | 341 | 282 | 27 | 2 | 29 | 373 | 271 | 27 | 40 | 34 |
| VIII. Working capital (revolving) funds | 130 | | | 75 | 55 | | | | | | −734 | −543 | −176 | −54 | 39 |
| Undistributed | | | | | | | | | | | 11 | −31 | 52 | | |
| Total | 37,337 | 8,131 | 10,696 | 17,732 | 777 | 41,042 | 9,725 | 11,511 | 19,151 | 656 | 39,062 | 9,051 | 10,906 | 18,435 | 669 |
| Available by transfer | −590 | −400 | −190 | | | | | | | | | | | | |
| Total, new obligational authority | 36,747 | 7,731 | 10,506 | 17,732 | 777 | | | | | | | | | | |

[1] Less than $0.5 million.

*New obligational availability, by major budget category, fiscal year 1960 with 9-year comparisons (excludes military assistance)*

[Millions of dollars]

| Budget category | Fiscal year 1960, President's budget | | Fiscal year 1959, includes proposed supplementals [1] | | Fiscal year 1958 | | Fiscal year 1957 | | Fiscal year 1956 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent |
| DEPARTMENT OF DEFENSE | | | | | | | | | | |
| I. Military personnel costs | 10,642 | 26 | 10,720 | 26 | 10,398 | 28 | 10,438 | 28 | 10,526 | 31 |
| II. Operation and maintenance | 9,633 | 23 | 9,436 | 23 | 9,369 | 25 | 8,947 | 25 | 8,644 | 25 |
| III. Major procurement and production | (14,398) | 35 | (15,325) | 37 | (11,399) | 31 | (11,737) | 32 | (9,653) | 29 |
| (a) Aircraft | 6,353 | | 6,346 | | 5,726 | | 6,303 | | 6,241 | |
| (b) Missiles | 3,961 | | 4,345 | | 2,313 | | 2,322 | | 938 | |
| (c) Ships and harbor craft | 1,343 | | 1,977 | | 1,781 | | 1,387 | | 1,317 | |
| (d) Combat vehicles | 111 | | 107 | | | | 32 | | 31 | |
| (e) Support vehicles | 172 | | 245 | | 39 | | 77 | | 42 | |
| (f) Artillery | 22 | | 13 | | | | (2) | | 1 | |
| (g) Weapons | 46 | | 51 | | 2 | | 24 | | 25 | |
| (h) Ammunition | 290 | | 274 | | 114 | | 233 | | 384 | |
| (i) Electronics and communications | 1,451 | | 1,241 | | 696 | | 599 | | 347 | |
| (j) Production equipment and facilities | 265 | | 291 | | 332 | | 402 | | 203 | |
| (k) Other major procurement and production | 384 | | 436 | | 397 | | 358 | | 123 | |
| IV. Military construction | 1,506 | 4 | 1,342 | 3 | 2,004 | 5 | 1,805 | 5 | 1,928 | 6 |
| V. Reserve components | (1,153) | 3 | (1,183) | 3 | (1,204) | 3 | (1,210) | 3 | (1,000) | 3 |
| (a) Construction | 57 | | 26 | | 74 | | 94 | | 76 | |
| (b) Other | 1,096 | | 1,157 | | 1,130 | | 1,115 | | 924 | |
| VI. Research and development | 2,711 | 6 | 2,639 | 6 | 1,912 | 5 | 1,710 | 5 | 1,420 | 4 |
| VII. DOD establishmentwide activities | (1,118) | 3 | (1,027) | 2 | (921) | 3 | (820) | 2 | (76) | 2 |
| (a) Retired pay | 715 | | 645 | | 567 | | 515 | | 495 | |
| (b) Other | 403 | | 382 | | 354 | | 305 | | 271 | |
| VIII. Working capital (revolving) funds | 30 | | | | 130 | | 75 | | | |
| Total, new obligational availability | 41,190 | 100 | 41,673 | 100 | 37,337 | 100 | 36,742 | 100 | 33,937 | 100 |
| Transfers from unobligated balances, etc | −340 | | −535 | | −590 | | −487 | | −750 | |
| New obligational authority, budget document | 40,850 | | 41,138 | | 36,747 | | 36,255 | | 33,187 | |

See footnotes at end of table.

*New obligational availability, by major budget category, fiscal year 1960 with 9-year comparisons (excludes military assistance)*—Continued

[Millions of dollars]

| Budget category | Fiscal year 1960, President's budget | | Fiscal year 1959, includes proposed supplementals [1] | | Fiscal year 1958 | | Fiscal year 1957 | | Fiscal year 1956 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent |
| DEPARTMENT OF THE ARMY | | | | | | | | | | |
| I. Military personnel costs | 3,514 | 37 | 3,551 | 37 | 3,489 | 43 | 3,594 | 45 | 3,679 | 47 |
| II. Operation and maintenance | 2,714 | 28 | 2,770 | 29 | 2,813 | 35 | 2,795 | 36 | 2,643 | 34 |
| III. Major procurement and production | (1,468) | 15 | (1,693) | 17 | (20) | | | | | |
| (a) Aircraft | 70 | | 130 | | | | | | | |
| (b) Missiles | 634 | | 672 | | 20 | | | | | |
| (c) Ships and harbor craft | 5 | | | | | | | | | |
| (d) Combat vehicles | 100 | | 107 | | | | | | | |
| (e) Support vehicles | 111 | | 187 | | | | | | | |
| (f) Artillery | 20 | | 13 | | | | | | | |
| (g) Weapons | 15 | | 38 | | | | | | | |
| (h) Ammunition | 114 | | 82 | | | | | | | |
| (i) Electronics and communications | 203 | | 257 | | | | | | | |
| (j) Production equipment and facilities | 117 | | 136 | | | | | | | |
| (k) Other major procurement and production | 79 | | 71 | | | | | | | |
| IV. Military construction | 341 | 4 | 230 | 2 | 310 | 4 | 202 | 3 | 485 | 6 |
| V. Reserve components | (648) | 7 | (662) | 7 | (700) | 9 | (659) | 8 | (520) | 7 |
| (a) Construction | 31 | | 6 | | 55 | | 55 | | 32 | |
| (b) Other | 617 | | 656 | | 645 | | 604 | | 489 | |
| VI. Research and development | 573 | 6 | 532 | 5 | 506 | 6 | 433 | 5 | 352 | 4 |
| VII. DOD establishmentwide activities | 298 | 3 | 280 | 3 | 294 | 3 | 219 | 3 | 170 | 2 |
| VIII. Working capital (revolving) funds | | | | | | | | | | |
| Total, new obligational availability | 9,557 | 100 | 9,718 | 100 | 8,131 | 100 | 7,901 | 100 | 7,849 | 100 |
| Transfers from unobligated balances, etc | −200 | | −375 | | −400 | | −229 | | −495 | |
| New obligational authority, budget document | 9,357 | | 9,343 | | 7,731 | | 7,672 | | 7,354 | |
| DEPARTMENT OF THE NAVY | | | | | | | | | | |
| I. Military personnel costs | 3,164 | 28 | 3,218 | 27 | 3,094 | 29 | 3,123 | 30 | 3,138 | 33 |
| II. Operation and maintenance | 2,645 | 23 | 2,544 | 21 | 2,537 | 24 | 2,406 | 23 | 2,386 | 25 |
| III. Major procurement and production | (4,374) | 38 | (4,822) | 40 | (4,000) | 38 | (3,748) | 36 | (2,939) | 30 |
| (a) Aircraft | 1,725 | | 1,680 | | 1,536 | | 1,483 | | 761 | |
| (b) Missiles | 703 | | 735 | | 402 | | 352 | | 238 | |
| (c) Ships and harbor craft | 1,338 | | 1,977 | | 1,781 | | 1,387 | | 1,317 | |
| (d) Combat vehicles | 11 | | | | | | 32 | | 31 | |
| (e) Support vehicles | 22 | | 18 | | 17 | | 30 | | 29 | |
| (f) Artillery | 2 | | | | | | (3) | | 1 | |
| (g) Weapons | 32 | | 13 | | 2 | | 23 | | 25 | |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| (h) Ammunition | 108 | ---- | 99 | ---- | 14 | ---- | 119 | ---- | 296 | ---- |
| (i) Electronics and communications | 308 | ---- | 181 | ---- | 144 | ---- | 189 | ---- | 151 | ---- |
| (j) Production equipment and facilities | 40 | ---- | 35 | ---- | 32 | ---- | 68 | ---- | 19 | ---- |
| (k) Other major procurement and production | 86 | ---- | 84 | ---- | 72 | ---- | 65 | ---- | 71 | ---- |
| IV. Military construction | 244 | 2 | 295 | 3 | 265 | 2 | 400 | 4 | 443 | 5 |
| V. Reserve components | (217) | 2 | (215) | 2 | (198) | 2 | (233) | 2 | (244) | 2 |
| (a) Construction | 9 | ---- | 8 | ---- | ---- | ---- | 10 | ---- | 28 | ---- |
| (b) Other | 208 | ---- | 207 | ---- | 198 | ---- | 223 | ---- | 216 | ---- |
| VI. Research and development | 783 | 7 | 831 | 7 | 573 | 5 | 542 | 5 | 474 | 5 |
| VII. DOD establishmentwide activities | 34 | ---- | 32 | ---- | 28 | ---- | 26 | ---- | 25 | ---- |
| VIII. Working capital (revolving) funds | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- |
| Total, new obligational availability | 11,460 | 100 | 11,958 | 100 | 10,696 | 100 | 10,478 | 100 | 9,648 | 100 |
| Transfers from unobligated balances, etc | −90 | ---- | −160 | ---- | −190 | ---- | −258 | ---- | ---- | ---- |
| New obligational authority, budget document | 11,370 | ---- | 11,798 | ---- | 10,506 | ---- | 10,220 | ---- | 9,648 | ---- |
| **DEPARTMENT OF THE AIR FORCE** | | | | | | | | | | |
| I. Military personnel costs | 3,964 | 21 | 3,951 | 21 | 3,815 | 21 | 3,721 | 21 | 3,709 | 24 |
| II. Operation and maintenance | 4,274 | 23 | 4,123 | 22 | 4,019 | 23 | 3,745 | 21 | 3,615 | 23 |
| III. Major procurement and production | (8,555) | 46 | (8,810) | 47 | (7,379) | 42 | (7,989) | 45 | (6,614) | 42 |
| (a) Aircraft | 4,558 | ---- | 4,535 | ---- | 4,190 | ---- | 4,821 | ---- | 5,480 | ---- |
| (b) Missiles | 2,624 | ---- | 2,938 | ---- | 1,890 | ---- | 1,970 | ---- | 700 | ---- |
| (c) Ships and harbor craft | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- |
| (d) Combat vehicles | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- |
| (e) Support vehicles | 39 | ---- | 40 | ---- | 22 | ---- | 47 | ---- | 14 | ---- |
| (f) Artillery | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- | ---- |
| (g) Weapons | (*) | ---- | ---- | ---- | ---- | ---- | 1 | ---- | ---- | ---- |
| (h) Ammunition | 68 | ---- | 93 | ---- | 100 | ---- | 115 | ---- | 88 | ---- |
| (i) Electronics and communications | 940 | ---- | 803 | ---- | 552 | ---- | 410 | ---- | 197 | ---- |
| (j) Production equipment and facilities | 108 | ---- | 120 | ---- | 300 | ---- | 334 | ---- | 84 | ---- |
| (k) Other major procurement and production | 219 | ---- | 281 | ---- | 325 | ---- | 293 | ---- | 52 | ---- |
| IV. Military construction | 898 | 5 | 785 | 4 | 1,420 | 8 | 1,198 | 7 | 994 | 6 |
| V. Reserve components | (288) | 1 | (306) | 2 | (306) | 2 | (318) | 2 | (236) | 1 |
| (a) Construction | 17 | ---- | 12 | ---- | 19 | ---- | 29 | ---- | 16 | ---- |
| (b) Other | 271 | ---- | 294 | ---- | 287 | ---- | 289 | ---- | 220 | ---- |
| VI. Research and development | 750 | 4 | 740 | 4 | 715 | 4 | 724 | 4 | 593 | 4 |
| VII. DOD establishmentwide activities | 3 | ---- | 3 | ---- | 3 | ---- | 2 | ---- | 10 | ---- |
| VIII. Working capital (revolving) funds | ---- | ---- | ---- | ---- | 75 | ---- | ---- | ---- | ---- | ---- |
| Total new obligational availability | 18,732 | 100 | 18,717 | 100 | 17,732 | 100 | 17,697 | 100 | 15,772 | 100 |
| Transfers from unobligated balances, etc | −50 | ---- | ---- | ---- | ---- | ---- | ---- | ---- | −255 | ---- |
| New obligational authority, budget document | 18,682 | ---- | 18,717 | ---- | 17,732 | ---- | 17,697 | ---- | 15,517 | ---- |

See footnotes at end of table.

*New obligational availability, by major budget category, fiscal year 1960 with 9-year comparisons (excludes military assistance)*—Continued

[Millions of dollars]

| Budget category | Fiscal year 1960, President's budget | | Fiscal year 1959, includes proposed supplementals [1] | | Fiscal year 1958 | | Fiscal year 1957 | | Fiscal year 1956 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent |
| OSD AND INTERSERVICE ACTIVITIES | | | | | | | | | | |
| I. Military personnel costs | | | | | | | | | | |
| II. Operation and maintenance | | | | | | | | | | |
| III. Major procurement and production | | | | | | | | | (100) | 15 |
| (a) Aircraft | | | | | | | | | | |
| (b) Missiles | | | | | | | | | | |
| (c) Ships and harbor craft | | | | | | | | | | |
| (d) Combat vehicles | | | | | | | | | | |
| (e) Support Vehicles | | | | | | | | | | |
| (f) Artillery | | | | | | | | | | |
| (g) Weapons | | | | | | | | | | |
| (h) Ammunition | | | | | | | | | | |
| (i) Electronics and communications | | | | | | | | | | |
| (j) Production equipment and facilities | | | | | | | | | 100 | |
| (k) Other major procurement and production | | | | | | | | | | |
| IV. Military construction | 23 | 2 | 32 | 2 | 9 | 1 | 5 | 1 | 6 | 1 |
| V. Reserve components | | | | | | | | | | |
| (a) Construction | | | | | | | | | | |
| (b) Other | | | | | | | | | | |
| VI. Research and development | 605 | 42 | 536 | 42 | 117 | 15 | 12 | 2 | [2] | |
| VII. DOD Establishmentwide activities | (783) | 54 | (711) | 56 | (596) | 77 | (574) | 86 | (561) | 84 |
| (a) Retired pay | 715 | | 645 | | 567 | | 515 | | 495 | |
| (b) Other | 68 | | 66 | | 29 | | 59 | | 66 | |
| VIII. Working capital (revolving) funds | 30 | 2 | | | 55 | 7 | 75 | 11 | | |
| Total, new obligational availability | 1,441 | 100 | 1,279 | 100 | 777 | 100 | 666 | 100 | 667 | 100 |
| Transfers from unobligated balances, etc. | | | | | | | | | | |
| New obligational authority, budget document | 1,441 | | 1,279 | | 777 | | 666 | | 667 | |

[1] Proposed fiscal year 1959 supplementals:

| | *Millions* |
|---|---|
| Army | $51.7 |
| Navy | 127.6 |
| Air Force | 108.8 |
| OSD | 6.1 |
| Total | 294.2 |

[2] Less than $0.5 million.

NOTE.—Amounts will not necessarily add to totals due to rounding. Fiscal year 1955–60 include appropriations to special fund accounts.

*New obligational availability, by major budget category, fiscal year 1960 with 9-year comparisons (excludes military assistance)*—Con.

[Millions of dollars]

| Budget category | Fiscal year 1955 | | Fiscal year 1954 | | Fiscal year 1953 | | Fiscal year 1952 | | Fiscal year 1951 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent |
| DEPARTMENT OF DEFENSE | | | | | | | | | | |
| I. Military personnel costs | 10, 800 | 36 | 11, 259 | 33 | 11, 916 | 25 | 10, 867 | 18 | 8, 342 | 18 |
| II. Operation and maintenance | 8, 166 | 27 | 9, 648 | 28 | 9, 908 | 21 | 12, 085 | 20 | 11, 180 | 24 |
| III. Major procurement and production | (7, 149) | 24 | (10, 432) | 30 | (19, 956) | 43 | (29, 536) | 49 | (23, 114) | 48 |
| (a) Aircraft | 4, 403 | | 4, 470 | | 13, 346 | | 13, 471 | | 8, 686 | |
| (b) Missiles | 345 | | 748 | | 896 | | 468 | | 424 | |
| (c) Ships and harbor craft | 1, 182 | | 782 | | 675 | | 1, 977 | | 826 | |
| (d) Combat vehicles | 25 | | 101 | | 246 | | 3, 977 | | 2, 449 | |
| (e) Support vehicles | 23 | | 94 | | 163 | | 1, 792 | | 1, 165 | |
| (f) Artillery | 9 | | 47 | | 13 | | 320 | | 361 | |
| (g) Weapons | 21 | | 70 | | 58 | | 338 | | 206 | |
| (h) Ammunition | 448 | | 2, 790 | | 2, 850 | | 2, 544 | | 3, 693 | |
| (i) Electronics and communications | 406 | | 448 | | 668 | | 1, 418 | | 1, 563 | |
| (j) Production equipment and facilities | 70 | | 642 | | 619 | | 2, 273 | | 2, 699 | |
| (k) Other major procurement and production | 216 | | 239 | | 423 | | 958 | | 1, 041 | |
| IV. Military construction | 820 | 3 | 244 | 1 | 2, 292 | 5 | 3, 997 | 7 | 2, 432 | 5 |
| V. Reserve componets | (740) | 3 | (665) | 2 | (491) | 1 | (628) | 1 | (691) | 1 |
| (a) Construction | 64 | | 67 | | 34 | | 42 | | 24 | |
| (b) Other | 677 | | 598 | | 457 | | 586 | | 667 | |
| VI. Research and development | 1, 305 | 4 | 1, 389 | 4 | 1, 586 | 3 | 1, 455 | 2 | 1, 176 | 2 |
| VII. DOD establishmentwide activities | (749) | 3 | (836) | 2 | (821) | 2 | (1, 417) | 2 | (1, 103) | 2 |
| (a) Retired pay | 424 | | 387 | | 357 | | 345 | | 342 | |
| (b) Other | 325 | | 449 | | 464 | | 1, 072 | | 761 | |
| VIII. Working capital (revolving) funds | | | | | 70 | | 450 | 1 | 143 | |
| Total, new obligational availability | 29, 728 | 100 | 34, 474 | 100 | 47, 041 | 100 | 60, 436 | 100 | 48, 182 | 100 |
| Transfers from unobligated balances, etc | 1, 059 | | | | | | | | | |
| New obligational authority, budget document | 30, 787 | | | | | | | | | |

*New obligational availability, by major budget category, fiscal year 1960 with 9-year comparisons (excludes military assistance)*—Con.

[Millions of dollars]

| Budget category | Fiscal year 1955 | | Fiscal year 1954 | | Fiscal year 1953 | | Fiscal year 1952 | | Fiscal year 1951 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent |
| DEPARTMENT OF THE ARMY | | | | | | | | | | |
| I. Military personnel costs | 4,300 | | 4,703 | 36 | 5,185 | 38 | 4,769 | 25 | 4,085 | 21 |
| II. Operation and maintenance | 2,434 | 32 | 4,090 | 32 | 4,003 | 30 | 5,509 | 26 | 5,216 | 27 |
| III. Major procurement and production | (1) | | (3,161) | 24 | (2,736) | 20 | (8,688) | 40 | (8,238) | 42 |
| (a) Aircraft | | | 114 | | 25 | | 44 | | 135 | |
| (b) Missiles | | | 225 | | 301 | | 253 | | 173 | |
| (c) Ships and harbor craft | | | 1 | | 50 | | 137 | | 86 | |
| (d) Combat vehicles | | | 87 | | 98 | | 3,663 | | 2,297 | |
| (e) Support vehicles | | | 37 | | 70 | | 1,365 | | 736 | |
| (f) Artillery | | | 39 | | 11 | | 320 | | 361 | |
| (g) Weapons | | | 29 | | 3 | | 72 | | 16 | |
| (h) Ammunition | | | 2,184 | | 1,924 | | 1,353 | | 2,196 | |
| (i) Electronics and communications | | | 80 | | 183 | | 550 | | 726 | |
| (j) Production equipment and facilities | 1 | | 333 | | | | 600 | | 1,100 | |
| (k) Other major procurement and production | | | 32 | | 71 | | 330 | | 413 | |
| IV. Military construction | 4 | | 3 | | 589 | 4 | 1,003 | 5 | 507 | 3 |
| V. Reserve components | (382) | 5 | (347) | 3 | (247) | 2 | (370) | 1 | (428) | 2 |
| (a) Construction | 33 | | 9 | | 20 | | 24 | | 24 | |
| (b) Other | 349 | | 337 | | 228 | | 345 | | 404 | |
| VI. Research and development | 363 | 5 | 374 | 3 | 470 | 4 | 436 | 2 | 336 | 2 |
| VII. DOD establishmentwide activities | 175 | 2 | 262 | 2 | 308 | 2 | 865 | 1 | 550 | 3 |
| VIII. Working capital (revolving) funds | | | | | 70 | | | | | |
| Total, new obligational availability | 7,660 | 100 | 12,939 | 100 | 13,608 | 100 | 21,640 | 100 | 19,360 | 100 |
| Transfers from unobligated balances, etc | 104 | | | | | | | | | |
| New obligational authority, budget document | 7,764 | | | | | | | | | |
| DEPARTMENT OF THE NAVY | | | | | | | | | | |
| I. Military personnel costs | 3,032 | 31 | 3,272 | 35 | 3,383 | 27 | 3,082 | 19 | 2,321 | 19 |
| II. Operation and maintenance | 2,339 | 24 | 2,466 | 26 | 2,773 | 22 | 3,186 | 20 | 2,907 | 23 |
| III. Major procurement and production | (3,648) | 37 | (2,936) | 31 | (5,327) | 42 | (7,825) | 49 | (6,022) | 48 |
| (a) Aircraft | 1,923 | | 1,276 | | 3,119 | | 3,335 | | 2,304 | |
| (b) Missiles | 126 | | 159 | | 181 | | 119 | | 130 | |
| (c) Ships and harbor craft | 1,102 | | 781 | | 625 | | 1,802 | | 714 | |
| (d) Combat vehicles | 25 | | 14 | | 148 | | 314 | | 152 | |
| (e) Support vehicles | 23 | | 35 | | 45 | | 120 | | 78 | |
| (f) Artillery | 9 | | 8 | | 1 | | | | | |
| (g) Weapons | 21 | | 41 | | 55 | | 266 | | 190 | |
| (h) Ammunition | 206 | | 452 | | 607 | | 594 | | 850 | |
| (i) Electronics and communications | 96 | | 67 | | 168 | | 469 | | 730 | |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| (j) Production equipment and facilities | 23 | | 19 | | 242 | | 611 | | 723 | |
| (k) Other major procurement and production | 93 | | 83 | | 138 | | 194 | | 151 | |
| IV. Military construction | 98 | 1 | | | 363 | 3 | 820 | 5 | 470 | 4 |
| V. Reserve components | (160) | 2 | (156) | 2 | (112) | 1 | (152) | 1 | (119) | 1 |
| (a) Construction | 15 | | 30 | | | | | | | |
| (b) Other | 145 | | 126 | | 112 | | 152 | | 119 | |
| VI. Research and development | 434 | 4 | 448 | 5 | 498 | 4 | 507 | 3 | 432 | 4 |
| VII. DOD establishmentwide activities | 54 | 1 | 56 | 1 | 77 | 1 | 76 | | 68 | |
| VIII. Working capital (revolving) funds | | | | | | | 450 | 3 | 143 | 1 |
| Total, new obligational availability | 9,766 | 100 | 9,333 | 100 | 12,533 | 100 | 16,098 | 100 | 12,481 | 100 |
| Transfers from unobligated balances, etc | 455 | | | | | | | | | |
| New obligational authority, budgetdocument | 10,221 | | | | | | | | | |
| DEPARTMENT OF THE AIR FORCE | | | | | | | | | | |
| I. Military personnel costs | 3,467 | 30 | 3,285 | 29 | 3,349 | 16 | 3,017 | 14 | 1,936 | 12 |
| II. Operation and maintenance | 3,392 | 29 | 3,092 | 27 | 3,132 | 15 | 3,390 | 15 | 3,058 | 19 |
| III. Major procurement and production | (3,419) | 30 | (4,085) | 36 | (11,893) | 59 | (13,023) | 59 | (8,854) | 56 |
| (a) Aircraft | 2,480 | | 3,080 | | 10,202 | | 10,091 | | 6,247 | |
| (b) Missiles | 219 | | 364 | | 414 | | 95 | | 121 | |
| (c) Ships and harbor craft | | | | | | | 39 | | 26 | |
| (d) Combat vehicles | | | | | | | | | | |
| (e) Support vehicles | | | 21 | | 48 | | 306 | | 351 | |
| (f) Artillery | | | | | | | | | | |
| (g) Weapons | | | | | | | | | | |
| (h) Ammunition | 242 | | 154 | | 320 | | 597 | | 647 | |
| (i) Electronics and communications | 309 | | 301 | | 318 | | 399 | | 108 | |
| (j) Production equipment and facilities | 46 | | 41 | | 377 | | 1,062 | | 876 | |
| (k) Other major procurement and production | 123 | | 124 | | 214 | | 435 | | 477 | |
| IV. Military construction | 630 | 5 | 241 | 2 | 1,200 | 6 | 2,174 | 10 | 1,456 | 9 |
| V. Reserve components | (199) | 2 | (162) | 2 | (132) | 1 | (107) | | (144) | 1 |
| (a) Construction | 16 | | 28 | | 14 | | 18 | | | |
| (b) Other | 183 | | 134 | | 118 | | 89 | | 144 | |
| VI. Research and development | 499 | 4 | 511 | 4 | 606 | 3 | 511 | 2 | 408 | 3 |
| VII. DOD establishmentwide activities | 30 | | 34 | | 33 | | 43 | | 42 | |
| VIII. Working capital (revolving) funds | | | | | | | | | | |
| Total new obligational availability | 11,637 | 100 | 11,410 | 100 | 20,346 | 100 | 22,265 | 100 | 15,896 | 100 |
| Transfers from unobligated balances, etc | 500 | | | | | | | | | |
| New obligational authority, budget document | 12,137 | | | | | | | | | |

*New obligational availability, by major budget category, fiscal year 1960 with 9-year comparisons (excludes military assistance)*—Con.

| Budget category | Fiscal year 1955 | | Fiscal year 1954 | | Fiscal year 1953 | | Fiscal year 1952 | | Fiscal year 1951 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent |
| OSD AND INTERSERVICE ACTIVITIES | | | | | | | | | | |
| I. Military personnel costs | | | | | | | | | | |
| II. Operation and maintenance | | | | | | | | | | |
| III. Major procurement and production | (80) | 12 | (250) | 32 | | | | | | |
| (a) Aircraft | | | | | | | | | | |
| (b) Missiles | | | | | | | | | | |
| (c) Ships and harbor craft | 80 | | | | | | | | | |
| (d) Combat vehicles | | | | | | | | | | |
| (e) Support vehicles | | | | | | | | | | |
| (f) Artillery | | | | | | | | | | |
| (g) Weapons | | | | | | | | | | |
| (h) Ammunition | | | | | | | | | | |
| (i) Electronics and communications | | | | | | | | | | |
| (j) Production equipment and facilities | | | 250 | | | | | | | |
| (k) Other major procurement and production | | | | | | | | | | |
| IV. Military construction | 89 | 13 | | | 140 | 25 | | | | |
| V. Reserve components | | | | | | | | | | |
| (a) Construction | | | | | | | | | | |
| (b) Other | | | | | | | | | | |
| VI. Research and development | 8 | 1 | 57 | 7 | 12 | 2 | | | | |
| VII. DOD establishmentwide activities | (489) | 74 | (485) | 61 | (403) | 73 | (433) | 100 | (444) | 100 |
| (a) Retired pay | 424 | | 387 | | 357 | | 345 | | 342 | |
| (b) Other | 65 | | 98 | | 46 | | 88 | | 102 | |
| VIII. Working capital (revolving) funds | | | | | | | | | | |
| Total, new obligational availability | 665 | 100 | 791 | 100 | 555 | 100 | 433 | 100 | 444 | 100 |
| Transfers from unobligated balances, etc | | | | | | | | | | |
| New obligational authority, budget document | 665 | | | | | | | | | |

*Expenditures, by major budget category, fiscal year 1960 with 9-year comparisons (excludes military assistance)*

[Millions of dollars]

| Budget category | Fiscal year 1960 estimated | | Fiscal year 1959 estimated | | Fiscal year 1958 actual | | Fiscal year 1957 actual | | Fiscal year 1956 actual | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent |
| DEPARTMENT OF DEFENSE | | | | | | | | | | |
| I. Military personnel costs | 10,617 | 26 | 10,636 | 26 | 10,440 | 27 | 10,384 | 27 | 10,666 | 30 |
| II. Operation and maintenance | 9,542 | 23 | 9,570 | 23 | 9,113 | 23 | 9,214 | 24 | 8,519 | 24 |
| III. Major procurement and production | (14,596) | 36 | (14,234) | 35 | (14,677) | 38 | (13,649) | 36 | (12,182) | 34 |
| (a) Aircraft | 6,589 | ------- | 7,117 | ------- | 8,448 | ------- | 7,978 | ------- | 7,146 | ------- |
| (b) Missiles | 3,922 | ------- | 3,360 | ------- | 2,737 | ------- | 2,095 | ------- | 1,168 | ------- |
| (c) Ships and harbor craft | 1,643 | ------- | 1,418 | ------- | 1,156 | ------- | 897 | ------- | 895 | ------- |
| (d) Combat vehicles | 161 | ------- | 148 | ------- | 66 | ------- | 266 | ------- | 48 | ------- |
| (e) Support vehicles | 107 | ------- | 78 | ------- | 150 | ------- | 124 | ------- | 190 | ------- |
| (f) Artillery | 13 | ------- | 8 | ------- | −8 | ------- | 24 | ------- | 28 | ------- |
| (g) Weapons | 28 | ------- | 28 | ------- | 9 | ------- | [1] | ------- | −165 | ------- |
| (h) Ammunition | 262 | ------- | 335 | ------- | 324 | ------- | 471 | ------- | 1,380 | ------- |
| (i) Electronics and communications | 1,057 | ------- | 735 | ------- | 877 | ------- | 881 | ------- | 770 | ------- |
| (j) Production equipment and facilities | 272 | ------- | 351 | ------- | 453 | ------- | 462 | ------- | 440 | ------- |
| (k) Other procurement and production | 541 | ------- | 656 | ------- | 465 | ------- | 451 | ------- | 282 | ------- |
| IV. Military construction | 1,660 | 4 | 1,988 | 5 | 1,693 | 4 | 1,906 | 5 | 2,005 | 6 |
| V. Reserve components | (1,164) | 3 | (1,204) | 3 | (1,185) | 3 | (1,054) | 3 | (854) | 2 |
| (a) Construction | 62 | ------- | 88 | ------- | 97 | ------- | 78 | ------- | 59 | ------- |
| (b) Other | 1,101 | ------- | 1,116 | ------- | 1,087 | ------- | 976 | ------- | 796 | ------- |
| VI. Research and development | 2,594 | 6 | 2,355 | 6 | 1,742 | 5 | 1,686 | 4 | 1,491 | 4 |
| VII. DOD establishmentwide activities | (1,109) | 3 | (1,052) | 3 | (935) | 2 | (849) | 2 | (688) | 2 |
| (a) Retired pay | 715 | ------- | 645 | ------- | 562 | ------- | 511 | ------- | 477 | ------- |
| (b) Other | 394 | ------- | 407 | ------- | 373 | ------- | 338 | ------- | 211 | ------- |
| VIII. Working capital (revolving) funds | −336 | −1 | −240 | −1 | −734 | −2 | −414 | −1 | −635 | −2 |
| Undistributed | ------- | ------- | ------- | ------- | 11 | ------- | 111 | ------- | −66 | ------- |
| Subtotal, Standard Form 133 basis | 40,945 | 100 | 40,800 | 100 | 39,062 | 100 | 38,439 | 100 | 35,705 | 100 |
| Adjustment to Treasury combined statement | ------- | ------- | ------- | ------- | ------- | ------- | ------- | ------- | 86 | ------- |
| Total, Treasury basis | 40,945 | 100 | 40,800 | 100 | 39,062 | 100 | 38,439 | 100 | 35,791 | 100 |

See footnotes at **end of table.**

*Expenditures, by major budget category, fiscal year 1960 with 9-year comparisons (excludes military assistance)*—Continued

| Budget category | Fiscal year 1960 estimated | | Fiscal year 1959 estimated | | Fiscal year 1958 actual | | Fiscal year 1957 actual | | Fiscal year 1956 actual | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent |
| DEPARTMENT OF THE ARMY | | | | | | | | | | |
| I. Military personnel costs | 3,506 | 38 | 3,519 | 38 | 3,541 | 39 | 3,595 | 40 | 3,836 | 44 |
| II. Operation and maintenance | 2,746 | 30 | 2,774 | 30 | 2,831 | 31 | 2,643 | 29 | 2,541 | 29 |
| III. Major procurement and production | (1,520) | 16 | (1,303) | 14 | (1,505) | 17 | (1,534) | 17 | (1,339) | 15 |
| (a) Aircraft | 143 | | 115 | | 157 | | 166 | | 134 | |
| (b) Missiles | 695 | | 587 | | 724 | | 414 | | 333 | |
| (c) Ships and harbor craft | 3 | | 2 | | 3 | | 1 | | 1 | |
| (d) Combat vehicles | 140 | | 121 | | 33 | | 221 | | −88 | |
| (e) Support vehicles | 47 | | 41 | | 124 | | 59 | | 118 | |
| (f) Artillery | 12 | | 8 | | −24 | | 24 | | −5 | |
| (g) Weapons | 16 | | 19 | | (1) | | 3 | | −197 | |
| (h) Ammunition | 62 | | 58 | | 110 | | 251 | | 718 | |
| (i) Electronics and communications | 251 | | 215 | | 198 | | 216 | | 153 | |
| (j) Production equipment and facilities | 49 | | 36 | | 123 | | 150 | | 164 | |
| (k) Other procurement and production | 104 | | 101 | | 58 | | 30 | | 7 | |
| IV. Military construction | 267 | 3 | 345 | 4 | 343 | 4 | 415 | 5 | 394 | 4 |
| V. Reserve components | (650) | 7 | (680) | 8 | (668) | 7 | (566) | 6 | (426) | 5 |
| (a) Construction | 37 | | 41 | | 42 | | 41 | | 23 | |
| (b) Other | 613 | | 639 | | 626 | | 525 | | 403 | |
| VI. Research and development | 547 | 6 | 519 | 6 | 476 | 5 | 435 | 5 | 410 | 5 |
| VII. DOD establishmentwide activities | 294 | 3 | 301 | 3 | 271 | 3 | 206 | 2 | 173 | 2 |
| VIII. Working capital (revolving) funds | −266 | −3 | −275 | −3 | −543 | −6 | −395 | −4 | −370 | −4 |
| Undistributed | | | | | −41 | | 63 | 1 | −57 | |
| Subtotal, Standard Form 133 basis | 9,264 | 100 | 9,165 | 100 | 9,051 | 100 | 9,063 | 100 | 8,693 | 100 |
| Adjustment to Treasury combined statement | | | | | | | | | 9 | |
| Total, Treasury basis | 9,264 | 100 | 9,165 | 100 | 9,051 | 100 | 9,063 | 100 | 8,702 | 100 |
| DEPARTMENT OF THE NAVY | | | | | | | | | | |
| I. Military personnel costs | 3,152 | 27 | 3,168 | 28 | 3,082 | 28 | 3,080 | 30 | 3,059 | 31 |
| II. Operation and maintenance | 2,605 | 22 | 2,583 | 23 | 2,494 | 23 | 2,475 | 24 | 2,319 | 24 |
| III. Major procurement and production | (4,595) | 40 | (4,369) | 38 | (4,233) | 39 | (3,755) | 36 | (3,627) | 37 |
| (a) Aircraft | 1,778 | | 1,972 | | 2,207 | | 1,996 | | 1,831 | |
| (b) Missiles | 566 | | 417 | | 345 | | 264 | | 195 | |
| (c) Ships and harbor craft | 1,640 | | 1,413 | | 1,138 | | 864 | | 892 | |
| (d) Combat vehicles | 22 | | 27 | | 33 | | 45 | | 136 | |
| (e) Support vehicles | 24 | | 29 | | 14 | | 28 | | 27 | |
| (f) Artillery | 1 | | (1) | | 16 | | (1) | | 33 | |
| (g) Weapons | 11 | | 8 | | 11 | | 12 | | | |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| (h) Ammunition | 157 | | 167 | | 161 | | 278 | | 298 | |
| (i) Electronics and communications | 233 | | 175 | | 143 | | 119 | | 103 | |
| (j) Production equipment and facilities | 73 | | 88 | | 80 | | 68 | | 60 | |
| (k) Other procurement and production | 91 | | 72 | | 85 | | 82 | | 53 | |
| IV. Military construction | 305 | 3 | 393 | 3 | 406 | 4 | 370 | 4 | 218 | 2 |
| V. Reserve components | (215) | 2 | (223) | 2 | (220) | 2 | (226) | 2 | (211) | 2 |
| (a) Construction | 10 | | 15 | | 19 | | 15 | | 17 | |
| (b) Other | 205 | | 208 | | 201 | | 211 | | 194 | |
| VI. Research and development | 779 | 7 | 716 | 6 | 569 | 5 | 523 | 5 | 449 | |
| VII. DOD establishmentwide activities | 33 | | 31 | | 27 | | 25 | | 24 | |
| VIII. Working capital (revolving) funds | −87 | −1 | −10 | | −176 | −2 | −103 | −1 | −168 | −1 |
| Undistributed | | | | | 52 | 1 | 47 | | −9 | |
| Subtotal, Standard Form 133 basis | 11, 596 | 100 | 11, 472 | 100 | 10, 906 | 100 | 10, 398 | 100 | 9, 730 | 100 |
| Adjustment to Treasury combined statement | | | | | | | | | 14 | |
| Total, Treasury basis | 11, 596 | 100 | 11, 472 | 100 | 10, 906 | 100 | 10, 398 | 100 | 9, 744 | 100 |
| **DEPARTMENT OF THE AIR FORCE** | | | | | | | | | | |
| I. Military personnel costs | 3, 959 | 21 | 3, 949 | 21 | 3, 817 | 21 | 3, 709 | 20 | 3, 770 | 23 |
| II. Operation and maintenance | 4, 191 | 22 | 4, 213 | 22 | 3, 788 | 21 | 4, 095 | 22 | 3, 659 | 22 |
| III. Major procurement and production | (8, 480) | 45 | (8, 560) | 45 | (8, 925) | 48 | (8, 330) | 46 | (7, 216) | 43 |
| (a) Aircraft | 4, 669 | | 5, 030 | | 6, 084 | | 5, 817 | | 5, 181 | |
| (b) Missiles | 2, 661 | | 2, 356 | | 1, 668 | | 1, 417 | | 641 | |
| (c) Ships and harbor craft | (1) | | (1) | | (1) | | (1) | | (1) | |
| (d) Combat vehicles | | | | | | | | | | |
| (e) Support vehicles | 37 | | 8 | | 12 | | 37 | | 44 | |
| (f) Artillery | | | | | | | | | | |
| (g) Weapons | 1 | | 1 | | −2 | | −14 | | 33 | |
| (h) Ammunition | 42 | | 109 | | 54 | | −57 | | 364 | |
| (i) Electronics and communications | 573 | | 346 | | 537 | | 545 | | 514 | |
| (j) Production equipment and facilities | 151 | | 227 | | 251 | | 245 | | 217 | |
| (k) Other procurement and production | 346 | | 483 | | 322 | | 340 | | 222 | |
| IV. Military construction | 1, 043 | 6 | 1, 200 | 6 | 928 | 5 | 1, 083 | 6 | 1, 328 | 8 |
| V. Reserve components | (299) | 2 | (301) | 2 | (297) | 1 | (262) | 1 | (217) | 1 |
| (a) Construction | 15 | | 32 | | 37 | | 22 | | 19 | |
| (b) Other | 284 | | 269 | | 261 | | 239 | | 199 | |
| VI. Research and development | 725 | 4 | 755 | 4 | 694 | 4 | 729 | 4 | 632 | 4 |
| VII. DOD establishmentwide activities | 3 | | 11 | | 40 | | 71 | | −15 | |
| VIII. Working capital (revolving) funds | −25 | | 4 | | −54 | | 84 | | −97 | −1 |
| Undistributed | | | | | | | | | | |
| Subtotal. Standard Form 133 basis | 18, 675 | 100 | 18, 993 | 100 | 18, 435 | 100 | 18, 363 | 100 | 16, 711 | 100 |
| Adjustment to Treasury combined statement | | | | | | | | | 38 | |
| Total, Treasury basis | 18, 675 | 100 | 18, 993 | 100 | 18, 435 | 100 | 18, 363 | 100 | 16, 749 | 100 |

See footnote at end of table.

*Expenditures, by major budget category, fiscal year 1960 with 9-year comparisons (excludes military assistance)*—Continued

| Budget category | Fiscal year 1960 estimated | | Fiscal year 1959 estimated | | Fiscal year 1958 actual | | Fiscal year 1957 actual | | Fiscal year 1956 actual | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent |
| OSD AND INTERSERVICE ACTIVITIES | | | | | | | | | | |
| I. Military personnel costs | | | | | | | | | | |
| II. Operation and maintenance | | | | | | | | | | |
| III. Major procurement and production | (1) | | (3) | | (15) | 2 | (31) | 5 | | |
| (a) Aircraft | | | | | | | | | | |
| (b) Missiles | | | | | | | | | | |
| (c) Ships and harbor craft | 1 | | 3 | | 15 | | 31 | | | |
| (d) Combat vehicles | | | | | | | | | | |
| (e) Support vehicles | | | | | | | | | | |
| (f) Artillery | | | | | | | | | | |
| (g) Weapons | | | | | | | | | | |
| (h) Ammunition | | | | | | | | | | |
| (i) Electronics and communications | | | | | | | | | | |
| (j) Production equipment and facilities | | | | | | | | | | |
| (k) Other procurement and production | | | | | | | | | | |
| IV. Military construction | 45 | 3 | 50 | 4 | 16 | 2 | 38 | 6 | 65 | 11 |
| V. Reserve components | | | | | | | | | | |
| (a) Construction | | | | | | | | | | |
| (b) Other | | | | | | | | | | |
| VI. Research and development | 543 | 39 | 365 | 31 | 3 | 1 | | | | |
| VII. DOD establishmentwide activities | (780) | 55 | (709) | 61 | (596) | 89 | (546) | 89 | (506) | 89 |
| (a) Retired pay | 715 | | 645 | | 562 | | 511 | | 477 | |
| (b) Other | 65 | | 64 | | 34 | | 35 | | 28 | |
| VIII. Working capital (revolving) funds | 42 | 3 | 42 | 4 | 39 | 6 | [1] | | | |
| Undistributed | | | | | | | | | | |
| Subtotal, Standard Form 133 basis | 1,410 | 100 | 1,170 | 100 | 669 | 100 | 615 | 100 | 571 | 100 |
| Adjustment to Treasury combined statement | | | | | | | | | 25 | |
| Total, Treasury basis | 1,410 | 100 | 1,170 | 100 | 669 | 100 | 615 | 100 | 596 | 100 |

*Expenditures, by major budget category, fiscal year 1960 with 9-year comparisons (excludes military assistance)*—Continued

[Millions of dollars]

| Budget category | Fiscal year 1955 actual | | Fiscal year 1954 actual | | Fiscal year 1953 actual | | Fiscal year 1952 actual | | Fiscal year 1951 actual | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent |
| DEPARTMENT OF DEFENSE | | | | | | | | | | |
| I. Military personnel costs | 10,643 | 30 | 10,961 | 27 | 11,556 | 27 | 11,152 | 29 | 7,148 | 36 |
| II. Operation and maintenance | 7,905 | 22 | 9,357 | 23 | 10,379 | 24 | 11,682 | 30 | 6,715 | 34 |
| III. Major procurement and production | (12,997) | 37 | (15,958) | 39 | (17,123) | 39 | (11,478) | 29 | (3,976) | 20 |
| (a) Aircraft | 8,037 | | 8,335 | | 7,417 | | 4,888 | | 2,412 | |
| (b) Missiles | 718 | | 504 | | 295 | | 169 | | 21 | |
| (c) Ships and harbor craft | 1,009 | | 1,090 | | 1,191 | | 624 | | 382 | |
| (d) Combat vehicles | 740 | | 677 | | 1,926 | | 1,014 | | 189 | |
| (e) Support vehicles | 296 | | 240 | | 408 | | 900 | | 57 | |
| (f) Artillery | 17 | | 187 | | −56 | | 235 | | 44 | |
| (g) Weapons | −92 | | −146 | | 389 | | 120 | | | |
| (h) Ammunition | 669 | | 2,736 | | 2,344 | | 1,322 | | 402 | |
| (i) Electronics and communications | 636 | | 826 | | 1,001 | | 597 | | 193 | |
| (j) Production equipment and facilities | 631 | | 1,122 | | 1,654 | | 1,007 | | 74 | |
| (k) Other procurement and production | 335 | | 388 | | 554 | | 602 | | 202 | |
| IV. Military construction | 1,582 | 4 | 1,706 | 4 | 1,913 | 4 | 1,819 | 5 | 440 | 2 |
| V. Reserve components | (717) | 2 | (584) | 2 | (522) | 1 | (476) | 1 | (537) | 3 |
| (a) Construction | 59 | | 37 | | 34 | | 15 | | 27 | |
| (b) Other | 658 | | 547 | | 488 | | 461 | | 510 | |
| VI. Research and development | 1,391 | 4 | 1,385 | 4 | 1,412 | 3 | 1,164 | 3 | 758 | 3 |
| VII. DOD establishmentwide activities | (654) | 2 | (771) | 2 | (759) | 2 | (729) | 2 | (628) | 3 |
| (a) Retired pay | 419 | | 386 | | 357 | | 329 | | 321 | |
| (b) Other | 236 | | 385 | | 402 | | 400 | | 307 | |
| VIII. Working capital (revolving) funds | −501 | −1 | −317 | −1 | 80 | | 295 | 1 | −159 | −1 |
| Undistributed | 149 | | 79 | | −31 | | 26 | | | |
| Subtotal, Standard Form 133 basis | 35,539 | 100 | 40,484 | 100 | 43,713 | 100 | 38,822 | 100 | 20,043 | 100 |
| Adjustment to Treasury combined statement | −6 | | −148 | | −2 | | 150 | | −271 | |
| Total, Treasury basis | 35,532 | 100 | 40,336 | 100 | 43,711 | 100 | 38,972 | 100 | 19,772 | 100 |

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*Expenditures, by major budget category, fiscal year 1960 with 9-year comparisons (excludes military assistance)*—Continued

| Budget category | Fiscal year 1955 actual | | Fiscal year 1954 actual | | Fiscal year 1953 actual | | Fiscal year 1952 actual | | Fiscal year 1951 actual | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent |
| DEPARTMENT OF THE ARMY | | | | | | | | | | |
| I. Military personnel costs | 4,161 | 47 | 4,652 | 36 | 4,836 | 30 | 5,119 | 33 | 3,255 | 44 |
| II. Operation and maintenance | 2,418 | 27 | 3,741 | 29 | 4,330 | 26 | 5,695 | 36 | 2,960 | 40 |
| III. Major procurement and production | (1,196) | 14 | (3,448) | 27 | (5,794) | 35 | (3,976) | 25 | (359) | 5 |
| (a) Aircraft | 67 | | 83 | | 95 | | 51 | | 7 | |
| (b) Missiles | 238 | | 187 | | 119 | | 46 | | | |
| (c) Ships and harbor craft | 33 | | 163 | | 258 | | 41 | | 12 | |
| (d) Combat vehicles | 623 | | 582 | | 1,870 | | 993 | | 99 | |
| (e) Support vehicles | 138 | | −66 | | 214 | | 754 | | 2 | |
| (f) Artillery | 23 | | 187 | | −56 | | 235 | | 44 | |
| (g) Weapons | −145 | | −283 | | 222 | | 9 | | 3 | |
| (h) Ammunition | 29 | | 1,923 | | 1,807 | | 930 | | −44 | |
| (i) Electronics and communications | 28 | | 231 | | 512 | | 266 | | 53 | |
| (j) Production equipment and facilities | 172 | | 433 | | 583 | | 421 | | 64 | |
| (k) Other procurement and production | −8 | | 8 | | 168 | | 230 | | 119 | |
| IV. Military construction | 350 | 4 | 361 | 3 | 517 | 3 | 347 | 2 | 80 | 1 |
| V. Reserve components | (347) | 4 | (326) | 2 | (303) | 2 | (303) | 2 | (313) | 4 |
| (a) Construction | 25 | | 17 | | 18 | | 7 | | 16 | |
| (b) Other | 322 | | 309 | | 285 | | 296 | | 296 | |
| VI. Research and development | 400 | 4 | 396 | 3 | 382 | 2 | 288 | 2 | 162 | 2 |
| VII. DOD establishmentwide activities | 187 | 2 | 237 | 2 | 256 | 2 | 220 | 1 | 172 | 2 |
| VIII. Working capital (revolving) funds | −345 | −4 | −225 | −2 | 36 | | −267 | −1 | 120 | 2 |
| Undistributed | 160 | 2 | −3 | | −31 | | 26 | | | |
| Subtotal, Standard Form 133 basis | 8,875 | 100 | 12,933 | 100 | 16,424 | 100 | 15,706 | 100 | 7,421 | 100 |
| Adjustment to Treasury combined statement | 24 | | −23 | | −87 | | 2 | | 57 | |
| Total, Treasury basis | 8,899 | 100 | 12,910 | 100 | 16,337 | 100 | 15,708 | 100 | 7,477 | 100 |
| DEPARTMENT OF THE NAVY | | | | | | | | | | |
| I. Military personnel costs | 2,986 | 31 | 3,140 | 28 | 3,323 | 29 | 3,027 | 30 | 2,139 | 36 |
| II. Operation and maintenance | 2,244 | 23 | 2,558 | 22 | 2,820 | 24 | 2,866 | 29 | 1,994 | 34 |
| III. Major procurement and production | (3,725) | 38 | (4,762) | 42 | (4,253) | 36 | (2,653) | 27 | (1,453) | 25 |
| (a) Aircraft | 1,676 | | 1,998 | | 1,735 | | 1,205 | | 594 | |
| (b) Missiles | 176 | | 141 | | 95 | | 56 | | 5 | |
| (c) Ships and harbor craft | 895 | | 912 | | 925 | | 581 | | 370 | |
| (d) Combat vehicles | 116 | | 94 | | 56 | | 21 | | 90 | |
| (e) Support vehicles | 44 | | 91 | | 37 | | 32 | | 23 | |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| (f) Artillery | −6 | | | | | | | | | |
| (g) Weapons | 36 | | 135 | | 166 | | 111 | | −2 | |
| (h) Ammunition | 391 | | 674 | | 459 | | 258 | | 254 | |
| (i) Electronics and communications | 159 | | 274 | | 235 | | 121 | | 50 | |
| (j) Production equipment and facilities | 158 | | 314 | | 432 | | 118 | | 2 | |
| (k) Other procurement and production | 80 | | 127 | | 114 | | 149 | | 68 | |
| IV. Military construction | 147 | 1 | 352 | 3 | 489 | 4 | 380 | 4 | 124 | 2 |
| V. Reserve components | (163) | 2 | (108) | 1 | (105) | 1 | (96) | 1 | (104) | 2 |
| (a) Construction | 9 | | 1 | | | | | | | |
| (b) Other | 154 | | 107 | | 105 | | 96 | | 104 | |
| VI. Research and development | 467 | 5 | 476 | 4 | 499 | 4 | 448 | 4 | 327 | 5 |
| VII. DOD establishmentwide activities | 52 | 1 | 61 | | 73 | 1 | 79 | 1 | 56 | 1 |
| VIII. Working capital (revolving) funds | −75 | −1 | −148 | −1 | 111 | 1 | 436 | 4 | −280 | −5 |
| Undistributed | −11 | | 82 | 1 | | | | | | |
| Subtotal, Standard Form 133 basis | 9,697 | 100 | 11,390 | 100 | 11,672 | 100 | 9,985 | 100 | 5,920 | 100 |
| Adjustment to Treasury combined statement | 35 | | −97 | | 206 | | 176 | | −336 | |
| Total, Treasury basis | 9,733 | 100 | 11,293 | 100 | 11,878 | 100 | 10,161 | 100 | 5,584 | 100 |
| DEPARTMENT OF THE AIR FORCE | | | | | | | | | | |
| I. Military personnel costs | 3,496 | 21 | 3,169 | 21 | 3,397 | 22 | 3,006 | 24 | 1,754 | 28 |
| II. Operation and maintenance | 3,243 | 20 | 3,058 | 20 | 3,228 | 21 | 3,122 | 24 | 1,760 | 28 |
| III. Major procurement and production | (7,999) | 49 | (7,748) | 49 | (7,076) | 47 | (4,849) | 38 | (2,164) | 34 |
| (a) Aircraft | 6,295 | | 6,254 | | 5,586 | | 3,633 | | 1,812 | |
| (b) Missiles | 305 | | 176 | | 81 | | 66 | | 16 | |
| (c) Ships and harbor craft | 4 | | 15 | | 8 | | 2 | | | |
| (d) Combat vehicles | | | | | | | | | | |
| (e) Support vehicles | 114 | | 215 | | 157 | | 114 | | 32 | |
| (f) Artillery | | | | | | | | | | |
| (g) Weapons | 17 | | 2 | | 1 | | | | | |
| (h) Ammunition | 249 | | 139 | | 78 | | 134 | | 193 | |
| (i) Electronics and communications | 450 | | 320 | | 254 | | 210 | | 90 | |
| (j) Production equipment and facilities | 301 | | 375 | | 639 | | 467 | | 8 | |
| (k) Other procurement and production | 263 | | 253 | | 272 | | 223 | | 15 | |
| IV. Military construction | 1,037 | 6 | 961 | 6 | 970 | 6 | 1,092 | 9 | 236 | 4 |
| V. Reserve components | (207) | 1 | (150) | 1 | (114) | 1 | (77) | 1 | (120) | 2 |
| (a) Construction | 25 | | 19 | | 16 | | 9 | | 11 | |
| (b) Other | 182 | | 131 | | 98 | | 68 | | 109 | |
| VI. Research and development | 524 | 3 | 513 | 3 | 530 | 3 | 429 | 3 | 269 | 4 |
| VII. DOD establishmentwide activities | −41 | | 41 | | 22 | | 37 | | 41 | |
| VIII. Working capital (revolving) funds | −81 | | 56 | | −66 | | 126 | 1 | 1 | |
| Undistributed | | | | | | | | | | |
| Subtotal, Standard Form 133 basis | 16,385 | 100 | 15,696 | 100 | 15,208 | 100 | 12,738 | 100 | 6,344 | 100 |
| Adjustment to Treasury combined statement | 22 | | −28 | | −121 | | −27 | | 5 | |
| Total, Treasury basis | 16,407 | 100 | 15,668 | 100 | 15,087 | 100 | 12,711 | 100 | 6,349 | 100 |

See footnote at end of table.

*Expenditures, by major budget category, fiscal year 1960 with 9-year comparisons (excludes military assistance)*—Continued

[Millions of dollars]

| Budget category | Fiscal year 1955 actual | | Fiscal year 1954 actual | | Fiscal year 1953 actual | | Fiscal year 1952 actual | | Fiscal year actual | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent | amount | Percent |
| OSD AND INTERSERVICE ACTIVITIES | | | | | | | | | | |
| I. Military personnel costs | | | | | | | | | | |
| II. Operation and maintenance | | | | | | | | | | |
| III. Major procurement and production | (77) | 13 | | | | | | | | |
| (a) Aircraft | | | | | | | | | | |
| (b) Missiles | | | | | | | | | | |
| (c) Ships and harbor craft | 77 | | | | | | | | | |
| (d) Combat vehicles | | | | | | | | | | |
| (e) Support vehicles | | | | | | | | | | |
| (f) Artillery | | | | | | | | | | |
| (g) Weapons | | | | | | | | | | |
| (h) Ammunition | | | | | | | | | | |
| (i) Electronics and communications | | | | | | | | | | |
| (j) Production equipment and facilities | | | | | | | | | | |
| (k) Other procurement and production | | | | | | | | | | |
| IV. Military construction | 48 | 8 | 32 | 7 | 1 | | | | | |
| V. Reserve components | | | | | | | | | | |
| (a) Construction | | | | | | | | | | |
| (b) Other | | | | | | | | | | |
| VI. Research and development | | | | | | | | | | |
| VII. DOD establishmentwide activities | (457) | 79 | (432) | 93 | (408) | 100 | (393) | 100 | (358) | 100 |
| (a) Retired pay | 419 | | 386 | | 357 | | 329 | | 321 | |
| (b) Other | 33 | | 46 | | 51 | | 64 | | 38 | |
| VIII. Working capital (revolving) funds | | | | | | | | | | |
| Undistributed | | | | | | | | | | |
| Subtotal, Standard Form 133 basis | 581 | 100 | 464 | 100 | 409 | 100 | 393 | 100 | | |
| Adjustment to Treasury combined statement | −87 | | | | | | −1 | | | |
| Total, Treasury basis | 494 | 100 | 464 | 100 | 409 | 100 | 392 | 100 | | |

[1] Less than $0.5 million.

NOTE.—Amounts will not necessarily add to totals due to rounding.

*Obligations by major budget category, fiscal years 1958–60*

[Millions of dollars]

| Budget category | Fiscal year 1958 | | | Fiscal year 1959 | | | Fiscal year 1960 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Direct | Reimbursable | Total | Direct | Reimbursable | Total | Direct | Reimbursable | Total |
| Operating costs | 21,884 | 1,054 | 22,938 | 22,349 | 1,304 | 23,653 | 22,561 | 1,200 | 23,761 |
| Military personnel | 10,386 | 242 | 10,628 | 10,666 | 263 | 10,929 | 10,642 | 260 | 10,902 |
| Reserve components | 1,172 | 7 | 1,179 | 1,207 | 6 | 1,213 | 1,162 | 5 | 1,167 |
| Operation and maintenance | 9,424 | 795 | 10,219 | 9,438 | 999 | 10,437 | 9,639 | 927 | 10,566 |
| Establishmentwide activities | 902 | 10 | 912 | 1,038 | 36 | 1,074 | 1,118 | 8 | 1,126 |
| Retired pay | (561) | | (561) | (645) | | (645) | (715) | | (715) |
| Other | (341) | (10) | (351) | (393) | (36) | (429) | (403) | (8) | (411) |
| Capital costs | 19,157 | 1,117 | 20,274 | 21,086 | 1,303 | 22,389 | 20,147 | 513 | 20,659 |
| Major procurement and production | 15,755 | 1,072 | 16,827 | 16,459 | 1,190 | 17,649 | 15,914 | 407 | 16,320 |
| Aircraft | (8,237) | (234) | (8,471) | (7,451) | (208) | (7,659) | (6,948) | (76) | (7,024) |
| Missiles | (3,391) | (460) | (3,851) | (4,347) | (423) | (4,770) | (4,126) | (145) | (4,271) |
| Ships | (1,760) | (4) | (1,764) | (1,931) | (84) | (2,015) | (1,721) | (15) | (1,736) |
| Other | (2,366) | (374) | (2,740) | (2,730) | (475) | (3,205) | (3,118) | (172) | (3,290) |
| Research and development | 1,847 | 35 | 1,882 | 2,702 | 98 | 2,800 | 2,711 | 89 | 2,800 |
| Military construction | 1,556 | 10 | 1,566 | 1,925 | 15 | 1,940 | 1,523 | 15 | 1,538 |
| Total | 41,042 | 2,170 | 43,212 | 43,435 | 2,607 | 46,042 | 42,707 | 1,713 | 44,420 |

NOTE.—Fiscal year 1959 includes proposed supplemental of $294,200,000.

*New obligational authority, direct obligations and expenditures, fiscal years 1958–60*

[Millions of dollars]

| | New obligational authority, fiscal year— | | | Direct obligations, fiscal year— | | | Expenditures, fiscal year— | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1958 | 1959 | 1960 | 1958 | 1959 | 1960 | 1958 | 1959 | 1960 |
| Department of the Army | 7,731 | 9,343 | 9,357 | 9,725 | 9,719 | 9,907 | 9,051 | 9,165 | 9,264 |
| Department of the Navy | 10,506 | 11,798 | 11,370 | 11,511 | 12,510 | 12,081 | 10,906 | 11,472 | 11,596 |
| Department of the Air Force | 17,732 | 18,717 | 18,682 | 19,151 | 19,896 | 19,308 | 18,435 | 18,993 | 18,675 |
| Office of the Secretary of Defense | 777 | 1,279 | 1,441 | 656 | 1,310 | 1,411 | 669 | 1,170 | 1,410 |
| Total | [1]36,747 | [1]41,138 | [1]40,850 | 41,042 | 43,435 | 42,707 | 39,062 | 40,800 | 40,945 |

[1] In addition, new obligational availability to be derived by transfer from revolving funds, as follows:

| | Fiscal year 1958 | Fiscal year 1959 | Fiscal year 1960 |
|---|---|---|---|
| Army | 400 | 375 | 200 |
| Navy | 190 | 160 | 90 |
| Air Force | | | 50 |
| Total | 590 | 535 | 340 |

NOTE.—Includes proposed fiscal year 1959 supplemental of $294,200,000:

| | *Millions* |
|---|---|
| Army | $51.7 |
| Navy | 127.6 |
| Air Force | 108.8 |
| Office of the Secretary of Defense | 6.1 |

*New obligational authority, direct obligations and expenditures, fiscal years 1958–60*

[Millions of dollars]

| Title | New obligational authority, fiscal year— | | | Direct obligations, fiscal year— | | | Expenditures, fiscal year— | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1958 | 1959 | 1960 | 1958 | 1959 | 1960 | 1958 | 1959 | 1960 |
| Operating costs | 21,809 | 22,316 | 22,477 | 21,749 | 22,247 | 22,477 | 21,509 | 22,299 | 22,319 |
| Military personnel | 11,572 | 12,010 | 11,965 | 11,548 | 11,940 | 11,965 | 11,618 | 11,908 | 11,934 |
| Active Forces | (10,398) | (10,720) | (10,642) | (10,386) | (10,666) | (10,642) | (10,448) | (10,636) | (10,617) |
| Reserve Forces | (606) | (645) | (608) | (601) | (629) | (608) | (608) | (627) | (602) |
| Retired pay | (567) | (645) | (715) | (561) | (645) | (715) | (562) | (645) | (715) |
| Operation and maintenance | 10,237 | 10,306 | 10,512 | 10,201 | 10,307 | 10,512 | 9,890 | 10,391 | 10,385 |
| Capital costs | 15,398 | 19,357 | 18,683 | 19,292 | 21,188 | 20,231 | 18,614 | 19,225 | 19,030 |
| Procurement | 11,054 | 14,524 | 13,348 | 15,155 | 15,675 | 14,919 | 14,825 | 14,183 | 13,938 |
| Aircraft | (5,682) | (5,955) | (6,197) | (8,345) | (7,327) | (6,795) | (8,412) | (6,963) | (6,265) |
| Missiles | (2,414) | (4,154) | (3,548) | (3,123) | (4,103) | (3,764) | (2,677) | (3,332) | (3,825) |
| Ships | (1,781) | (1,978) | (1,342) | (1,760) | (1,930) | (1,719) | (1,457) | (1,677) | (1,659) |
| Other | (1,176) | (2,437) | (2,261) | (1,927) | (2,315) | (2,641) | (2,278) | (2,211) | (2,189) |
| Research, development, test and evaluation | 2,258 | 3,464 | 3,772 | 2,503 | 3,522 | 3,722 | 2,034 | 3,020 | 3,384 |
| Military construction | 2,086 | 1,369 | 1,563 | 1,634 | 1,991 | 1,589 | 1,755 | 2,021 | 1,708 |
| Active Forces | (2,004) | (1,342) | (1,502) | (1,556) | (1,925) | (1,519) | (1,657) | (1,933) | (1,644) |
| Reserve Forces | (82) | (27) | (61) | (78) | (66) | (70) | (98) | (88) | (64) |
| Revolving and management funds | 130 | ------- | 30 | ------- | ------- | ------- | −1,061 | −724 | −405 |
| Total | 37,337 | 41,673 | 41,190 | 41,042 | 43,435 | 42,707 | 39,062 | 40,800 | 40,945 |
| Available by transfer | −590 | −535 | −340 | ------- | ------- | ------- | ------- | ------- | ------- |
| Total, new obligational authority | 36,747 | [1] 41,138 | 40,850 | ------- | ------- | ------- | ------- | ------- | ------- |

[1] Includes proposed $294,200,000 supplemental request. Also includes approximately $700,000,000 of funds appropriated for fiscal year 1959 which have been applied to fiscal year 1960 programs. Excludes congressionally authorized transfers of $122,100,000 to NASA and GSA.

*Fiscal year 1960 budget summary*

[Millions of dollars]

| Budget category | New obligational authority | | | | | Direct obligations | | | | | Net expenditures | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Total | Army | Navy | Air Force | OSD | Total | Army | Navy | Air Force | OSD | Total | Army | Navy | Air Force | OSD |
| Operating costs | 22,477 | 7,114 | 6,088 | 8,492 | 783 | 22,477 | 7,114 | 6,088 | 8,492 | 783 | 22,319 | 7,108 | 6,025 | 8,407 | 780 |
| Military personnel | 11,965 | 3,908 | 3,275 | 4,066 | 715 | 11,965 | 3,908 | 3,276 | 4,066 | 715 | 11,934 | 3,897 | 3,264 | 4,058 | 715 |
| Active Forces | (10,642) | (3,514) | (3,164) | (3,964) | -------- | (10,642) | (3,514) | (3,164) | (3,964) | -------- | (10,617) | (3,506) | (3,152) | (3,959) | -------- |
| Reserve Forces | (608) | (394) | (112) | (102) | -------- | (608) | (394) | (112) | (102) | -------- | (602) | (391) | (112) | (99) | -------- |
| Retired pay | (715) | -------- | -------- | -------- | (715) | (715) | -------- | -------- | -------- | (715) | (715) | -------- | -------- | -------- | (715) |
| Operation and maintenance | 10,512 | 3,206 | 2,812 | 4,426 | 68 | 10,512 | 3,206 | 2,812 | 4,426 | 68 | 10,385 | 3,211 | 2,761 | 4,349 | 65 |
| Capital costs | 18,683 | 2,443 | 5,372 | 10,240 | 628 | 20,231 | 2,793 | 5,993 | 10,817 | 628 | 19,030 | 2,422 | 5,727 | 10,293 | 588 |
| Procurement | 13,348 | 1,025 | 4,148 | 8,176 | -------- | 14,919 | 1,373 | 4,747 | 8,799 | -------- | 13,938 | 1,209 | 4,504 | 8,224 | 1 |
| Aircraft | (6,197) | (63) | (1,725) | (4,409) | -------- | (6,795) | (85) | (1,866) | (4,845) | -------- | (6,265) | (126) | (1,778) | (4,362) | -------- |
| Missiles | (3,548) | (302) | (645) | (2,601) | -------- | (3,764) | (406) | (658) | (2,700) | -------- | (3,825) | (463) | (593) | (2,768) | -------- |
| Ships | (1,342) | (4) | (1,338) | -------- | -------- | (1,719) | (5) | (1,714) | -------- | -------- | (1,659) | (2) | (1,655) | ([1]) | (1) |
| Other | (2,261) | (656) | (440) | (1,165) | -------- | (2,641) | (877) | (509) | (1,255) | -------- | (2,189) | (618) | (178) | (1,094) | -------- |
| Research, development, test, and evaluation | 3,772 | 1,047 | 971 | 1,150 | 605 | 3,722 | 1,047 | 969 | 1,102 | 605 | 3,384 | 909 | 922 | 1,011 | 543 |
| Military construction | 1,563 | 372 | 253 | 915 | 23 | 1,589 | 374 | 277 | 915 | 23 | 1,708 | 304 | 301 | 1,058 | 45 |
| Active Forces | (1,502) | (341) | (244) | (894) | (23) | (1,519) | (336) | (266) | (894) | (23) | (1,644) | (267) | (291) | (1,041) | (45) |
| Reserve Forces | (61) | (31) | (9) | (21) | -------- | (70) | (38) | (11) | (21) | -------- | (64) | (37) | (10) | (17) | -------- |
| Revolving and management funds | 30 | -------- | -------- | -------- | 30 | -------- | -------- | -------- | -------- | -------- | −405 | −266 | −155 | −25 | 42 |
| Total | 41,190 | 9,557 | 11,460 | 18,732 | 1,441 | 42,707 | 9,907 | 12,081 | 19,308 | 1,411 | 40,945 | 9,264 | 11,596 | 18,675 | 1,410 |
| Available by transfer | −340 | −200 | −90 | −50 | -------- | -------- | -------- | -------- | -------- | -------- | -------- | -------- | -------- | -------- | -------- |
| Total, new obligational authority | 40,850 | 9,357 | 11,370 | 18,682 | 1,441 | -------- | -------- | -------- | -------- | -------- | -------- | -------- | -------- | -------- | -------- |

[1] Less than $500,000.

## *Fiscal year 1959 budget summary*

[Millions of dollars]

| Title | New obligational authority | | | | | Direct obligations | | | | | Expenditures | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Total | Army | Navy | Air Force | OSD | Total | Army | Navy | Air Force | OSD | Total | Army | Navy | Air Force | OSD |
| Operating costs | 22,316 | 7,213 | 6,059 | 8,333 | 711 | 22,247 | 7,176 | 6,031 | 8,329 | 711 | 22,299 | 7,160 | 6,030 | 8,400 | 709 |
| Military personnel | 12,010 | 3,980 | 3,332 | 4,053 | 645 | 11,940 | 3,942 | 3,304 | 4,049 | 645 | 11,908 | 3,937 | 3,280 | 4,046 | 645 |
| Active Forces | (10,720) | (3,551) | (3,218) | (3,951) | ----- | (10,666) | (3,525) | (3,190) | (3,951) | ----- | (10,636) | (3,519) | (3,168) | (3,949) | ----- |
| Reserve Forces | (645) | (429) | (114) | (102) | ----- | (629) | (417) | (114) | (98) | ----- | (627) | (418) | (112) | (97) | ----- |
| Retired pay | (645) | ----- | ----- | ----- | (645) | (645) | ----- | ----- | ----- | (645) | (645) | ----- | ----- | ----- | (645) |
| Operation and maintenance | 10,306 | 3,232 | 2,727 | 4,280 | 66 | 10,307 | 3,233 | 2,727 | 4,280 | 66 | 10,391 | 3,223 | 2,750 | 4,354 | 64 |
| Capital costs | 19,357 | 2,506 | 5,899 | 10,385 | 568 | 21,188 | 2,543 | 6,480 | 11,567 | 598 | 19,225 | 2,279 | 5,947 | 10,581 | 418 |
| Procurement | 14,524 | 1,333 | 4,615 | 8,576 | ----- | 15,675 | 1,307 | 5,140 | 9,226 | 3 | 14,183 | 1,135 | 4,654 | 8,392 | 3 |
| Aircraft | (5,955) | (116) | (1,680) | (4,159) | ----- | (7,327) | (129) | (2,004) | (5,194) | ----- | (6,963) | (88) | (1,972) | (4,903) | ----- |
| Missiles | (4,154) | (589) | (682) | (2,884) | ----- | (4,103) | (650) | (666) | (2,787) | ----- | (3,332) | (471) | (543) | (2,318) | ----- |
| Ships | (1,978) | (3) | (1,975) | ----- | ----- | (1,930) | (3) | (1,924) | ([1]) | (3) | (1,677) | (2) | (1,672) | ([1]) | (3) |
| Other | (2,437) | (626) | (278) | (1,533) | ----- | (2,315) | (524) | (546) | (1,245) | ----- | (2,211) | (574) | (467) | (1,171) | ----- |
| Research, development, test and evaluation | 3,464 | 936 | 980 | 1,011 | 536 | 3,522 | 948 | 981 | 1,029 | 563 | 3,020 | 758 | 940 | 957 | 365 |
| Military construction | 1,369 | 236 | 303 | 798 | 32 | 1,991 | 288 | 358 | 1,313 | 32 | 2,021 | 386 | 353 | 1,232 | 50 |
| Active Forces | (1,342) | (230) | (295) | (785) | (32) | (1,925) | (250) | (343) | (1,300) | (32) | (1,933) | (345) | (338) | (1,200) | (50) |
| Reserve Forces | (27) | (6) | (8) | (13) | ----- | (66) | (38) | (15) | (13) | ----- | (88) | (41) | (15) | (32) | ----- |
| Revolving and management funds | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | −724 | −274 | −505 | 13 | 42 |
| Total | 41,673 | 9,718 | 11,958 | 18,717 | 1,279 | 4,435 | 9,719 | 12,510 | 19,896 | 1,310 | 40,800 | 9,165 | 11,472 | 18,993 | 1,170 |
| Available by transfer | −535 | −375 | −160 | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| Total, new obligational authority | 41,138 | 9,343 | 11,798 | 18,717 | 1,279 | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- |

[1] Less than $500,000.

NOTE.—Includes proposed fiscal year 1959 supplementals:

| | *Millions* |
|---|---|
| Army | $51.7 |
| Navy | $127.6 |
| Air Force | $108.8 |
| Office of the Secretary of Defense | 6.1 |
| Total | 294.2 |

*Fiscal year 1958 budgt summary*

[Millions of dollars]

| Title | New obligational authority | | | | | Direct obligations | | | | | Expenditures | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Total | Army | Navy | Air Force | OSD | Total | Army | Navy | Air Force | OSD | Total | Army | Navy | Air Force | OSD |
| Operating costs | 21,809 | 7,221 | 5,901 | 8,090 | 596 | 21,749 | 7,215 | 5,875 | 8,069 | 590 | 21,509 | 7,169 | 5,901 | 7,842 | 596 |
| Military personnel | 11,572 | 3,898 | 3,200 | 3,907 | 567 | 11,548 | 3,895 | 3,186 | 3,906 | 561 | 11,618 | 3,960 | 3,189 | 3,907 | 562 |
| Active Forces | (10,398) | (3,489) | (3,094) | (3,815) | | (10,386) | (3,489) | (3,083) | (3,815) | | (10,448) | (3,548) | (3,083) | (3,817) | |
| Reserve Forces | (606) | (408) | (106) | (92) | | (601) | (406) | (104) | (91) | | (608) | (412) | (106) | (90) | |
| Retired pay | (567) | | | | (567) | (561) | | | | (561) | (562) | | | | (562) |
| Operation and maintenance | 10,237 | 3,324 | 2,702 | 4,183 | 29 | 10,201 | 3,320 | 2,689 | 4,163 | 29 | 9,890 | 3,209 | 2,712 | 3,935 | 34 |
| Capital costs | 15,398 | 910 | 4,794 | 9,567 | 126 | 19,292 | 2,510 | 5,635 | 11,082 | 66 | 18,614 | 2,424 | 5,547 | 10,609 | 34 |
| Procurement | 11,054 | 20 | 3,833 | 7,201 | | 15,155 | 1,313 | 4,590 | 9,248 | 5 | 14,825 | 1,488 | 4,435 | 8,886 | 15 |
| Aircraft | (5,682) | | (1,536) | (4,146) | | (8,345) | (52) | (2,111) | (6,182) | | (8,412) | (148) | (2,207) | (6,058) | |
| Missiles | (2,414) | (20) | (355) | (2,039) | | (3,123) | (594) | (392) | (2,137) | | (2,677) | (699) | (330) | (1,648) | |
| Ships | (1,781) | | (1,781) | ([1]) | | (1,760) | ([1]) | (1,755) | ([1]) | (5) | (1,457) | (3) | (1,439) | ([1]) | (15) |
| Other | (1,176) | | (161) | (1,015) | | (1,927) | (667) | (332) | (928) | | (2,278) | (639) | (459) | (1,180) | |
| Research, development, test and evaluation | 2,258 | 525 | 696 | 919 | 117 | 2,503 | 801 | 728 | 923 | 50 | 2,034 | 550 | 724 | 758 | 3 |
| Military construction | 2,086 | 365 | 265 | 1,447 | 9 | 1,634 | 395 | 317 | 911 | 12 | 1,755 | 386 | 388 | 965 | 16 |
| Active Forces | (2,004) | (310) | (265) | (1,420) | (9) | (1,556) | (357) | (304) | (884) | (12) | (1,657) | (343) | (370) | (928) | (16) |
| Reserve Forces | (82) | (55) | | (27) | | (78) | (39) | (13) | (26) | | (98) | (43) | (19) | (37) | |
| Revolving and management funds | 130 | | | 75 | 55 | | | | | | −1,061 | −542 | −542 | −16 | 39 |
| Total | 37,337 | 8,131 | 10,696 | 17,732 | 777 | 41,042 | 9,725 | 11,511 | 19,151 | 656 | 39,062 | 9,051 | 10,906 | 18,435 | 669 |
| Available by transfer | −590 | −400 | −190 | | | | | | | | | | | | |
| Total, new obligational authority | 36,747 | 7,731 | 10,506 | 17,732 | 777 | | | | | | | | | | |

[1] Less than $500,000.

*Estimated expenditures and amounts available for expenditure, summary by service, fiscal years 1951–60*

[Millions of dollars]

| Available for expenditure | Total | Army | Navy | Air Force | OSD and inter-service activities |
|---|---|---|---|---|---|
| FISCAL YEAR 1951 | | | | | |
| Unexpended balance, July 1, 1950 | $9,854 | $2,436 | $3,584 | $3,823 | $10 |
| Plus: | | | | | |
| New expenditure availability | 48,179 | 19,282 | 12,396 | 15,816 | 684 |
| Transfers, net | ---------- | 94 | 84 | 62 | −240 |
| Equals: Total available | 58,033 | 21,813 | 16,064 | 19,702 | 455 |
| Less: | | | | | |
| Expenditures, actual (combined statement) | 19,772 | 7,478 | 5,584 | 6,349 | 362 |
| Lapsed funds | 115 | 31 | 67 | 18 | (1) |
| Equals: Unexpended balance, June 30, 1951 | 38,145 | 14,304 | 10,413 | 13,335 | 93 |
| FISCAL YEAR 1952 | | | | | |
| Plus: | | | | | |
| New expenditure availability | 60,494 | 21,633 | 16,088 | 22,244 | 529 |
| Transfers, net | −2 | −24 | +30 | +76 | −83 |
| Equals: Total available | 98,638 | 35,913 | 26,531 | 35,655 | 539 |
| Less: | | | | | |
| Expenditures, actual (combined statement) | 38,972 | 15,708 | 10,161 | 12,711 | 392 |
| Lapsed funds | 322 | 93 | 138 | 89 | 2 |
| Equals: Unexpended balance, June 30, 1952 | 59,344 | 20,113 | 16,232 | 22,855 | 145 |
| FISCAL YEAR 1953 | | | | | |
| Adjustments to unexpended balance brought forward [2] | 178 | 180 | −3 | 1 | (1) |
| Equals: Revised unexpended balance brought forward | 59,522 | 20,292 | 16,229 | 22,856 | 144 |
| Plus: | | | | | |
| New expenditure availability | 47,028 | 13,232 | 12,651 | 20,596 | 550 |
| Transfers, net | (1) | +277 | −96 | −173 | −8 |
| Equals: Total available | 106,550 | 33,801 | 28,784 | 43,279 | 687 |
| Less: | | | | | |
| Expenditures, actual (combined statement) | 43,711 | 16,337 | 11,878 | 15,087 | 409 |
| Lapsed funds | 573 | 162 | 250 | 118 | 43 |
| Equals: Unexpended balance, June 30, 1953 | 62,267 | 17,302 | 16,656 | 28,074 | 235 |
| FISCAL YEAR 1954 | | | | | |
| Adjustment to unexpended balance brought forward [3] | −115 | −95 | −14 | −6 | ---------- |
| Equals: Revised unexpended balance brought forward | 62,152 | 17,207 | 16,642 | 28,068 | 235 |
| Plus: | | | | | |
| New expenditure availability | 34,507 | 12,947 | 9,372 | 11,418 | 770 |
| Transfers, net | −174 | −138 | −50 | −7 | +21 |
| Rescissions | −535 | −285 | −250 | ---------- | ---------- |
| Equals: Total available | 95,950 | 29,731 | 25,715 | 39,479 | 1,026 |
| Less: | | | | | |
| Expenditures, actual (combined statement) | 40,336 | 12,910 | 11,293 | 15,668 | 464 |
| Lapsed funds | 527 | 189 | 118 | 155 | 65 |
| Equals: Unexpended balance, June 30, 1954 | 55,087 | 16,631 | 14,305 | 23,655 | 496 |
| FISCAL YEAR 1955 | | | | | |
| Plus: | | | | | |
| New expenditure availability | 29,728 | 7,660 | 9,766 | 11,637 | 666 |
| Transfers, net | −68 | −210 | −8 | 250 | −100 |
| Rescissions | −1,050 | −800 | −225 | −25 | ---------- |
| Equals: Total available | 83,698 | 23,282 | 23,838 | 35,517 | 1,062 |
| Less: | | | | | |
| Expenditures, actual (combined statement) | 35,532 | 8,899 | 9,733 | 16,407 | 494 |
| Lapsed funds | 2,804 | 1,724 | 735 | 326 | 19 |
| Equals: Unexpended balance, June 30, 1955 | 45,362 | 12,658 | 13,370 | 18,784 | 549 |
| Memo: Anticipated reimbursements from undelivered MAP orders | (4,178) | (902) | (245) | (3,031) | ---------- |

**See footnote at end of table.**

*Estimated expenditures and amounts available for expenditure, summary by service, fiscal years 1951–60*

[Millions of dollars]

| Available for expenditure | Total | Army | Navy | Air Force | OSD and inter-service activities |
|---|---|---|---|---|---|
| FISCAL YEAR 1956 | | | | | |
| Plus: | | | | | |
| New expenditure availability | $33,937 | $7,849 | $9,648 | $15,772 | $667 |
| Transfers, net | −816 | −750 | −66 | −85 | +85 |
| Rescissions | −1,658 | −700 | −503 | −455 | ---------- |
| Equals: Total available | 76,825 | 19,057 | 22,450 | 34,016 | 1,301 |
| Less: | | | | | |
| Expenditures, actual (combined statement) | 35,791 | 8,702 | 9,744 | 16,749 | 596 |
| Lapsed funds | 2,544 | 1,779 | 320 | 178 | 266 |
| Equals: Unexpended balance, June 30, 1956 | 38,490 | 8,576 | 12,386 | 17,089 | 439 |
| Memo: Anticipated reimbursements from undelivered MAP orders | (2,642) | (572) | (220) | (1,850) | ---------- |
| FISCAL YEAR 1957 | | | | | |
| Plus: | | | | | |
| New expenditure availability | 36,742 | 7,901 | 10,478 | 17,697 | 666 |
| Transfers, net | −114 | −169 | −49 | +81 | +23 |
| Rescissions | −718 | −467 | −201 | −50 | ---------- |
| Equals: Total available | 74,400 | 15,842 | 22,613 | 34,816 | 1,128 |
| Less: | | | | | |
| Expenditures, actual (combined statement) | 38,439 | 9,063 | 10,398 | 18,363 | 615 |
| Unobligated balances withdrawn | 1,301 | 476 | 377 | 138 | 309 |
| Equals: Unexpended balance, June 30, 1957 | 34,660 | 6,303 | 11,838 | 16,316 | 204 |
| Memo: Anticipated reimbursements from undelivered MAP orders | (2,252) | (649) | (229) | (1,373) | ---------- |
| FISCAL YEAR 1958 | | | | | |
| Plus: | | | | | |
| New expenditure availability | 37,330 | 8,128 | 10,693 | 17,731 | 777 |
| Transfers, net | −645 | −455 | −190 | ---------- | ---------- |
| Equals: Total available | 71,345 | 13,976 | 22,341 | 34,047 | 981 |
| Less: | | | | | |
| Expenditures, actual (combined statement) | 39,062 | 9,051 | 10,906 | 18,435 | 669 |
| Unobligated balances withdrawn | 199 | 40 | 43 | 96 | 19 |
| Equals: Unexpended balance, June 30, 1958 | 32,085 | 4,885 | 11,392 | 15,516 | 293 |
| Memo: Anticipated reimbursements from undelivered MAP orders | (2,232) | (1,080) | (262) | (890) | ---------- |
| FISCAL YEAR 1959, ESTIMATED | | | | | |
| Plus: | | | | | |
| New expenditure availability | 41,378 | 9,667 | 11,830 | 18,608 | 1,273 |
| Proposed supplementals | 294 | 52 | 128 | 109 | 6 |
| Transfers, net | −561 | −375 | −160 | ---------- | −26 |
| Equals: Total available | 73,197 | 14,228 | 23,189 | 34,233 | 1,546 |
| Less: | | | | | |
| Expenditures | 40,800 | 9,165 | 11,472 | 18,993 | 1,170 |
| Unobligated balances withdrawn | 103 | 21 | 41 | 38 | 3 |
| Equals: Unexpended balance, June 30, 1959 | 32,294 | 5,042 | 11,676 | 15,202 | 374 |
| Memo: Anticipated reimbursements from undelivered MAP orders | (1,592) | (740) | (309) | (544) | ---------- |
| FISCAL YEAR 1960, ESTIMATED | | | | | |
| Plus: | | | | | |
| New expenditure availability, basic request | 39,627 | 9,185 | 11,207 | 17,817 | 1,418 |
| New expenditure availability for later transmission | 1,563 | 372 | 253 | 915 | 23 |
| Transfers, net | −340 | −200 | −90 | −50 | ---------- |
| Equals: Total available | 73,144 | 14,399 | 23,046 | 33,884 | 1,815 |
| Less: | | | | | |
| Expenditures | 40,945 | 9,264 | 11,596 | 18,675 | 1,410 |
| Unobligated balances withdrawn | 4 | 1 | 4 | ---------- | ---------- |
| Equals: Unexpended balance, June 30, 1960 | 32,195 | 5,135 | 11,447 | 15,209 | 405 |
| Memo: Anticipated reimbursements from undelivered MAP orders | [4] (1,424) | (307) | (137) | (45) | ---------- |

[1] Less than $500,000.

[2] Adjustments to reflect change in accounting procedure throughout Government in handling of Economy Act working funds.

[3] Reflects reclassification of certain appropriations from "military" to "civil functions."

[4] Includes $935 million anticipated fiscal year 1960 MAP orders, not distributed by service.

NOTE.—Amounts will not necessarily add to totals due to rounding

***Obligations and obligational availability of current general and special fund appropriations, summary by service (excluding working, revolving, and expired general and special fund appropriations), fiscal years 1950–60***

[Thousands of dollars]

| | Total | Army | Navy | Air Force | OSD and interservice activities |
|---|---|---|---|---|---|
| FISCAL YEAR 1950, ACTUAL | | | | | |
| Unobligated balance July 1, 1949 | $872, 313 | $71, 390 | $567, 648 | $233, 275 | ------------ |
| Plus: | | | | | |
| New obligational availability fiscal year 1950 | 13, 169, 339 | 4, 233, 508 | 4, 073, 017 | 4, 671, 364 | $191, 450 |
| Direct congressional appropriations | (13, 041, 902) | (4, 405, 144) | (4, 328, 383) | [1] (4, 116, 925) | (191, 450) |
| Cash to liquidate prior contract authority | (−1,809,529) | (−220, 000) | (−789, 529) | [2] (−800, 000) | ------------ |
| New unfinanced contract authority | (1, 936, 966) | (48, 364) | [3] (534, 163) | [4] (1, 354, 439) | ------------ |
| Administrative adjustment of contract authority | −99, 081 | ------------ | −99, 081 | ------------ | ------------ |
| Reimbursements | 186, 436 | 33, 675 | 74, 228 | 78, 535 | ------------ |
| Transfers (net) | −22, 982 | −30, 350 | −26, 247 | 16, 615 | 17, 000 |
| Equals: Total available for obligation fiscal year 1950 | 14, 106, 029 | 4, 308, 224 | 4, 589, 565 | 4, 999, 789 | 208, 450 |
| Deduct: Obligations incurred fiscal year 1950 | 13, 163, 453 | 4, 066, 577 | 4, 159, 910 | 4, 729, 083 | 207, 883 |
| Equals: | | | | | |
| Unobligated balance June 30, 1950 | 942, 576 | 241, 647 | 429, 656 | 270, 706 | 567 |
| Expired as of June 30, 1950 | (137, 962) | (124, 165) | (3, 825) | (9, 405) | (567) |
| Available in fiscal year 1951 | (804, 614) | (117, 482) | (425, 831) | (261, 301) | ------------ |
| FISCAL YEAR 1951, ACTUAL | | | | | |
| Unobligated balance July 1, 1950 | 804, 614 | 117, 482 | 425, 831 | 261, 301 | ------------ |
| Plus: | | | | | |
| New obligational availability fiscal year 1951 | 48, 038, 560 | 19, 360, 143 | 12, 337, 975 | 15, 895, 975 | 444, 467 |
| Direct congressional appropriations | (48, 086, 926) | (19, 270, 030) | (12, 319, 074) | [1] (15, 813, 522) | (684, 300) |
| Cash to liquidate prior contract authority | (−2,317,600) | ------------ | (−767, 600) | (−1, 550, 000) | ------------ |
| New unfinanced contract authority | (2, 269, 233) | ------------ | [3] (700, 293) | [4] (1, 568, 940) | ------------ |
| Distribution of OSD emergency fund | ------------ | (90, 113) | (86, 207) | (63, 513) | (−239, 833) |
| Adjustment of unfinanced contract authority | −20, 560 | ------------ | −20, 560 | ------------ | ------------ |
| Reimbursements | 654, 212 | 138, 211 | 290, 822 | 224, 714 | 465 |
| Transfers (net) | −1, 886 | 2, 958 | −2, 862 | −1, 982 | ------------ |
| Equals: Total available for obligation fiscal year 1951 | 49, 474, 939 | 19, 618, 795 | 13, 031, 204 | 16, 380, 008 | 444, 932 |
| Deduct: Obligations incurred fiscal year 1951 | 45, 772, 330 | 17, 658, 609 | 12, 443, 623 | 15, 264, 406 | 405, 692 |
| Equals: | | | | | |
| Unobligated balance June 30, 1951 | 3, 702, 609 | 1, 960, 186 | 587, 581 | 1, 115, 602 | 39, 240 |
| Expired as of June 30, 1951 | (251, 732) | (65, 407) | (88, 980) | (58, 105) | (39, 240) |
| Available in fiscal year 1952 | (3, 450, 879) | (1, 894, 779) | (498, 602) | (1, 057, 497) | ------------ |

See footnotes at end of table.

*Obligations and obligational availability of current general and special fund appropriations, summary by service (excluding working, revolving, and expired general and special fund appropriations), fiscal years 1950–60*—Continued

[Thousands of dollars]

| | Total | Army | Navy | Air Force | OSD and interservice activities |
|---|---|---|---|---|---|
| FISCAL YEAR 1952, ACTUAL | | | | | |
| Unobligated balance July 1, 1951 | $3,450,879 | $1,894,779 | $498,602 | $1,057,497 | |
| Plus: | | | | | |
| New obligational availability fiscal year 1952 | 59,986,264 | 21,639,719 | 15,648,422 | 22,265,123 | $433,000 |
| Direct congressional appropriations | (61,411,104) | (21,648,032) | (16,291,087) | (22,948,985) | (523,000) |
| Cash to liquidate prior contract authority | (−1,424,840) | (−48,364) | (−666,476) | (−710,000) | |
| Transfer to offset pay deficiency | | (13,342) | | | (−13,342) |
| Distribution of OSD emergency fund | | (26,709) | (23,811) | (26,138) | (−76,658) |
| Reimbursements | 837,391 | 36,912 | 508,157 | 292,237 | 85 |
| Transfers (net) | 37,765 | −513 | 38,719 | −441 | |
| Equals: Total available for obligation fiscal year 1952 | 64,312,298 | 23,570,897 | 16,693,900 | 23,614,416 | 433,085 |
| Deduct: Obligations incurred fiscal year 1952 | 56,867,342 | 20,902,622 | 15,482,198 | 20,111,958 | 370,564 |
| Equals: | | | | | |
| Unobligated balance June 30, 1952 | 7,444,956 | 2,668,275 | 1,211,702 | 3,502,458 | 62,521 |
| Expired as of June 30, 1952 | (359,946) | (69,683) | (121,525) | (106,218) | (62,521) |
| Available in fiscal year 1953 | (7,085,010) | (2,598,592) | (1,090,177) | (3,396,240) | |
| FISCAL YEAR 1953, ACTUAL | | | | | |
| Unobligated balance July 1, 1952 | 7,085,010 | 2,598,592 | 1,090,177 | 3,396,240 | |
| Plus: | | | | | |
| New obligational availability fiscal year 1953 | 46,971,036 | 13,537,510 | 12,532,758 | 20,345,983 | 554,785 |
| Direct congressional appropriations | (49,198,317) | (13,124,410) | (13,205,745) | (22,318,362) | (549,800 |
| Cash to liquidate prior contract authority | (−2,307,681) | | (−577,302) | (−1,730,379) | |
| Transfer to offset pay deficiency | (80,400) | (400,400) | (−96,000) | (−250,000) | (26,000) |
| Distribution of OSD emergency fund | | (12,700) | (315) | (8,000) | (−21,015) |
| Reimbursements | 1,941,886 | 1,200,777 | 429,720 | 311,389 | |
| Transfers (net) | −49,643 | −48,933 | −568 | −142 | |
| Equals: Total available for obligation fiscal year 1953 | 55,948,287 | 17,287,946 | 14,052,086 | 24,053,470 | 554,785 |
| Deduct: Obligations incurred fiscal year 1953 | 45,734,793 | 14,194,587 | 12,256,645 | 18,747,624 | 535,936 |
| Equals: | | | | | |
| Unobligated balance June 30, 1953 | 10,213,494 | 3,093,359 | 1,795,441 | 5,305,846 | 18,849 |
| Expired as of June 30, 1953 | (821,755) | (268,091) | (489,049) | (46,009) | (18,607) |
| Available in fiscal year 1954 | (9,391,739) | (2,825,268) | (1,306,392) | (5,259,837) | (242) |
| FISCAL YEAR 1954, ACTUAL | | | | | |
| Unobligated balance July 1, 1953 | [5] 9,369,099 | [5] 2,802,629 | 1,306,392 | 5,259,837 | 242 |
| Plus: | | | | | |
| New obligation availability fiscal year 1954 | 34,473,599 | 12,938,992 | 9,333,356 | 11,410,496 | 790,755 |
| Direct congressional appropriations | (34,554,042) | (12,937,406) | (9,438,310) | (11,408,776) | (769,550) |
| Treasury restore warrant | (11) | (11) | | | |
| Cash to liquidate prior contract authority | (−80,454) | | (−80,454) | | |
| Transfers in lieu of supplemental appropriations | | | (−24,500) | | (24,500) |
| Distribution of OSD emergency fund | | (1,575) | | (1,720) | (−3,295) |
| Reimbursements | 2,507,433 | 1,652,302 | 402,808 | 452,323 | |
| Transfers (net) | −18,969 | −172,010 | 161,162 | −8,121 | |
| Equals: Total available for obligation fiscal year 1954 | 46,331,163 | 17,221,913 | 11,203,718 | 17,114,535 | 790,997 |

See footnotes at end of table.

***Obligations and obligational availability of current general and special fund appropriations, summary by service (excluding working, revolving, and expired general and special fund appropriations), fiscal years 1950–60***—Continued

[Thousands of dollars]

| | Total | Army | Navy | Air Force | OSD and interservice activities |
|---|---|---|---|---|---|
| FISCAL YEAR 1954 ACTUAL—con. | | | | | |
| Deduct: Obligations incurred fiscal year 1954 | $27,956,827 | $9,517,784 | $8,258,236 | $9,752,374 | $428,432 |
| Equals: | | | | | |
| Unobligated balance June 30, 1954 | 18,374,336 | 7,704,129 | 2,945,482 | 7,362,162 | 362,564 |
| Expired as of June 30, 1954 | (2,667,528) | (1,464,377) | (620,435) | (320,152) | (262,564) |
| Available in fiscal year 1955 | (15,706,808) | (6,239,752) | (2,325,046) | (7,042,010) | (100,000) |
| FISCAL YEAR 1955, ACTUAL | | | | | |
| Unobligated balance July 1, 1954 | 15,706,808 | 6,239,752 | 2,325,046 | 7,042,010 | 100,000 |
| Adjustment for inclusion of special fund accounts | 858 | | 858 | | |
| Plus: | | | | | |
| New obligational availability fiscal year 1955 | 29,728,218 | 7,659,581 | 9,765,833 | 11,637,139 | 665,665 |
| Direct congressional appropriations | (29,596,596) | (7,642,570) | (9,761,346) | (11,563,930) | (628,750) |
| Transfers | (97,622) | (17,011) | (−29,513) | (73,209) | (36,915) |
| Cash to liquidate prior contract authority | (34,000) | | (34,000) | | |
| Rescissions | −500,000 | −500,000 | | | |
| Other transfers | −76,220 | −44,500 | −16,375 | 84,624 | −99,970 |
| Reimbursements | 2,583,223 | 1,739,743 | 417,792 | 425,618 | 69 |
| Equals: Total available for obligation fiscal year 1955 | 47,442,887 | 15,094,576 | 12,493,155 | 19,189,391 | 665,765 |
| Deduct: | | | | | |
| Obligations incurred in fiscal year 1955 | 34,213,041 | 10,649,656 | 7,631,204 | 15,327,972 | 604,213 |
| Balances expiring on June 30, 1955 | 412,064 | 131,700 | 231,270 | 22,522 | 26,569 |
| Equals: Unobligated balance available in fiscal year 1956 | 12,817,781 | 4,313,220 | 4,630,681 | 3,838,897 | 34,983 |
| FISCAL YEAR 1956, ACTUAL | | | | | |
| Unobligated balance, July 1, 1955 | 12,817,781 | 4,313,220 | 4,630,681 | 3,838,897 | 34,983 |
| Plus: | | | | | |
| New obligational availability, fiscal year 1956 | 33,936,579 | 7,848,730 | 9,648,405 | 15,771,965 | 667,479 |
| Direct congressional appropriations | (33,148,763) | (7,344,453) | (9,588,948) | (15,513,154) | (702,208) |
| Transfers | (750,077) | (504,277) | (21,719) | (258,811) | (−34,729) |
| Reappropriations | (65,738) | | (65,738) | | |
| Cash to liquidate prior contract authority | (−28,000) | | (−28,000) | | |
| Rescissions | −8,572 | | −8,572 | | |
| Other transfers | −834,701 | −750,077 | | −84,624 | |
| Reimbursements | 4,904,580 | 1,317,609 | 573,260 | 3,013,695 | 16 |
| Fiscal year 1956 MAP common item orders | (3,989,686) | (967,195) | (260,061) | (2,762,430) | |
| All other sources | (914,894) | (350,414) | (313,199) | (251,265) | (16) |
| Equals: Total available for obligation, fiscal year 1956 | 50,815,667 | 12,729,482 | 14,843,774 | 22,539,933 | 702,478 |
| Deduct: | | | | | |
| Obligations incurred in fiscal year 1956 | 38,058,963 | 9,713,404 | 10,980,594 | 16,817,509 | 547,457 |
| Balances expiring on June 30, 1956 | 432,810 | 142,487 | 152,776 | −7,941 | 145,488 |
| Equals: | | | | | |
| Unobligated balance available in fiscal year 1957 | 12,323,894 | 2,873,591 | 3,710,404 | 5,730,366 | 9,533 |
| Anticipated earnings from MAP orders undelivered as of June 30, 1956 | (2,391,870) | (396,723) | (201,335) | (1,793,812) | |
| Appropriations and reimbursements available, other than undelivered MAP orders | (9,932,024) | (2,476,868) | (3,509,069) | (3,936,554) | (9,533) |

*Obligations and obligational availability of current general and special fund appropriations, summary by service (excluding working, revolving, and expired general and special fund appropriations), fiscal years 1950–60*—Continued

[Thousands of dollars]

| | Total | Army | Navy | Air Force | OSD and interservice activities |
|---|---|---|---|---|---|
| FISCAL YEAR 1957, ACTUAL | | | | | |
| Adjustment to consolidated basis of reporting | $56,087 | $17,241 | $19,048 | $8,805 | $10,993 |
| Plus: | | | | | |
| New obligational availability, fiscal year 1957 | 36,666,991 | 7,901,381 | 10,478,104 | 17,696,503 | 591,003 |
| Direct congressional appropriations | (36,180,573) | (7,646,266) | (10,183,732) | (17,686,300) | (664,275) |
| Transfers | (486,418) | (255,115) | (294,372) | (10,203) | (−73,272) |
| Rescissions | −46,110 | | −46,110 | | |
| Other transfers | −50,444 | −27,444 | −23,000 | | |
| Reimbursements | 2,467,403 | 1,510,663 | 358,397 | 598,343 | |
| Fiscal year 1957 MAP common item orders | (713,874) | (402,064) | (70,615) | (241,195) | |
| All other sources | (1,753,529) | (1,108,599) | (287,782) | (357,148) | |
| Equals: Total available for obligation, fiscal year 1957 | 51,417,821 | 12,275,431 | 14,496,844 | 24,034,017 | 611,529 |
| Deduct: | | | | | |
| Obligations incurred in fiscal year 1957 | 40,281,685 | 10,293,837 | 10,866,037 | 18,569,383 | 552,428 |
| Balances expiring on June 30, 1957 | 266,772 | 98,483 | 92,069 | 32,712 | 43,508 |
| Equals: | | | | | |
| Unobligated balances available in fiscal year 1958 | 10,869,364 | 1,883,111 | 3,538,737 | 5,431,922 | 15,593 |
| Anticipated earnings from MAP orders undelivered as of June 30, 1957 | (2,104,688) | (531,198) | (208,095) | (1,365,395) | |
| Appropriations and reimbursements available, other than undelivered MAP orders | (8,764,676) | (1,351,913) | (3,330,642) | (4,066,527) | (15,593) |
| FISCAL YEAR 1958, ACTUAL | | | | | |
| Plus: | | | | | |
| New obligational availability, fiscal year 1958 | 37,206,547 | 8,131,470 | 10,695,598 | 17,657,230 | 722,249 |
| Direct congressional appropriations | (36,695,668) | (7,694,875) | (10,522,387) | (17,765,181) | (713,225) |
| Reappropriations | (10,000) | (10,000) | | | |
| Transfers | (500,879) | (426,594) | (173,211) | (−107,951) | (9,024) |
| Reimbursements | 2,742,945 | 1,634,108 | 311,462 | 797,375 | |
| Fiscal year 1958 MAP common item orders | (1,113,925) | (656,285) | (107,792) | (349,848) | |
| All other sources | (1,629,020) | (977,823) | (203,670) | (447,527) | |
| Recoveries of prior obligations | 362,087 | 119,274 | 242,812 | | |
| Equals: Total available for obligation, fiscal year 1958 | 51,180,942 | 11,767,963 | 14,788,610 | 23,886,527 | 737,842 |
| Deduct: | | | | | |
| Obligations incurred in fiscal year 1958 | 43,212,146 | 11,062,232 | 11,809,311 | 19,684,959 | 655,643 |
| Balances expiring on June 30, 1958 | 70,266 | 5,708 | 33,498 | 22,056 | 9,005 |
| Equals: | | | | | |
| Unobligated balances available in fiscal year 1959 | [6] 7,905,411 | 700,023 | [6] 2,952,683 | 4,179,512 | 73,194 |
| Anticipated earnings from MAP orders undelivered as of June 30, 1958 | (1,991,448) | (868,833) | (236,675) | (885,939) | |
| Appropriations and reimbursements available, other than undelivered MAP orders | (5,913,964) | (−168,811) | (2,716,007) | (3,293,573) | (73,194) |
| FISCAL YEAR 1959, ESTIMATED | | | | | |
| Plus: | | | | | |
| New obligational availability, fiscal year 1959 | 41,672,552 | 9,718,281 | 11,957,816 | 18,717,176 | 1,279,278 |
| Direct congressional appropriations enacted | (40,965,477) | (9,229,109) | (11,671,227) | (18,672,224) | (1,392,917) |
| Proposed fiscal year 1959 supplementals | (294,200) | (51,676) | (127,611) | (108,800) | (6,113) |
| Transfers | (412,874) | (437,496) | (158,978) | (−63,848) | (−119,752) |
| Other transfers | −25,541 | | | | −25,541 |

See footnotes at end of table.

*Obligations and obligational availability of curent general and special fund appropriations, summary by service (excluding working, revolving, and expired general and special fund appropriations), fiscal year 1950–60*—Continued

[Thousands of dollars]

| | Total | Army | Navy | Air Force | OSD and interservice activities |
|---|---|---|---|---|---|
| FISCAL FROM 1959, ESTIMATED—con. | | | | | |
| Plus—Continued | | | | | |
| Anticipated reimbursements | $2,524,225 | $1,171,789 | $496,055 | $856,381 | ---------- |
| Fiscal year 1959 MAP common item orders | (797,812) | (210,000) | (203,312) | (384,500) | ---------- |
| All other sources | (1,726,413) | (961,789) | (292,743) | (471,881) | ---------- |
| Recoveries of prior obligations | 604,541 | 75,000 | 229,000 | 275,000 | $25,541 |
| Equals: Total available for obligation, fiscal year 1959 | 52,681,186 | 11,665,093 | 15,635,552 | 24,028,069 | 1,352,472 |
| Deduct: | | | | | |
| Obligations incurred in fiscal year 1959 | 46,042,361 | 10,990,804 | 12,975,938 | 20,765,957 | 1,309,662 |
| Balances expiring on June 30, 1959 | 72,057 | 37,105 | 28,396 | 3,746 | 2,810 |
| Equals: | | | | | |
| Unobligated balances available in fiscal year 1960 | 6,566,768 | 637,184 | 2,631,218 | 3,258,366 | 40,000 |
| Anticipated earnings from MAP orders undelivered as of June 30, 1959 | (1,364,172) | (574,163) | (268,905) | (521,104) | ---------- |
| Appropriations and reimbursements available, other than undelivered MAP orders | (5,202,596) | (63,021) | (2,362,313) | (2,737,262) | (40,000) |
| FISCAL YEAR 1960, ESTIMATED | | | | | |
| Plus: | | | | | |
| New obligational availability, fiscal year 1960 | 41,160,000 | 9,557,000 | 11,459 775 | 18,732,200 | 1,411,025 |
| Basic appropriation request | (39,256,800) | (8,985,000) | (11,116,775) | (17,767,200) | (1,387,825) |
| Proposed for later transmission | (1,563,200) | (372,000) | (253,000) | (915,000) | (23,200) |
| Transfers | (340,000) | (200,000) | (90,000) | (50,000) | ---------- |
| Anticipated reimbursements | 1,679,314 | 900,927 | 292,905 | 485,482 | ---------- |
| Fiscal year 1960 MAP common item orders [7] | (100,000) | (35,000) | (20,000) | (45,000) | ---------- |
| All other sources | (1,579,314) | (865,927) | (272,905) | (440,482) | ---------- |
| Recoveries of prior obligations | 275,000 | 50,000 | 100,000 | 125,000 | ---------- |
| Equals: Total available for obligation, fiscal year 1960 | 49,681,081 | 11,145,110 | 14,483,898 | 22,601,048 | 1,451,025 |
| Deduct: | | | | | |
| Obligations incurred in fiscal year 1960 | 44,420,037 | 10,839,927 | 12,410,303 | 19,758,782 | 1,411,025 |
| Balances expiring on June 30, 1960 | ---------- | ---------- | ---------- | ---------- | ---------- |
| Equals: | | | | | |
| Unobligated balances available in fiscal year 1961 | 5,261,044 | 305,183 | 2,073,595 | 2,842,266 | 40,000 |
| Anticipated earnings from MAP orders undelivered as of June 30, 1960 [7] | (449,714) | (282,163) | (122,551) | (45,000) | ---------- |
| Appropriations and reimbursements available, other than undelivered MAP orders | (4,811,330) | (23,020) | (1,951,044) | (2,797,266) | (40,000) |

[1] Fiscal year 1950 excludes and fiscal year 1951 includes $22,461,000 cash carried over to fiscal year 1951 from fiscal year 1950 reserve (Research and development, Air Force).

[2] Excludes $75,000,000 appropriation for payment of obligations incurred prior to June 30, 1946, against the appropriation "Air Corps, Army 1942–46." This amount does not represent cash to liquidate prior contract authority (Construction of Aircraft and Related Procurement, Air Force).

[3] Fiscal year 1950 excludes and fiscal year 1951 includes $124,797,000 contract authority carried over to fiscal year 1951 from fiscal year 1950 reserve (Construction of aircraft and related procurement, Navy).

[4] Fiscal year 1950 excludes and fiscal year 1951 includes $726,151,000 contract authority carried over to fiscal year 1951 from fiscal year 1950 reserve (Construction of aircraft and related procurement, Air Force).

[5] Differs from ending balance, fiscal year 1953, due to reclassification of "Civilian relief in Korea" from a military function to a civilian function.

[6] Excludes credit unobligated balance (deficiency) of $6,882 in "Medical care, Navy 1958."

[7] Excludes $935,000,000 of anticipated fiscal year 1960 MAP orders since distribution of such orders is not determinable at this time.

NOTE.—Amounts do not necessarily add to totals due to rounding. Amounts for fiscal year 1950–54 exclude activity under special fund accounts.

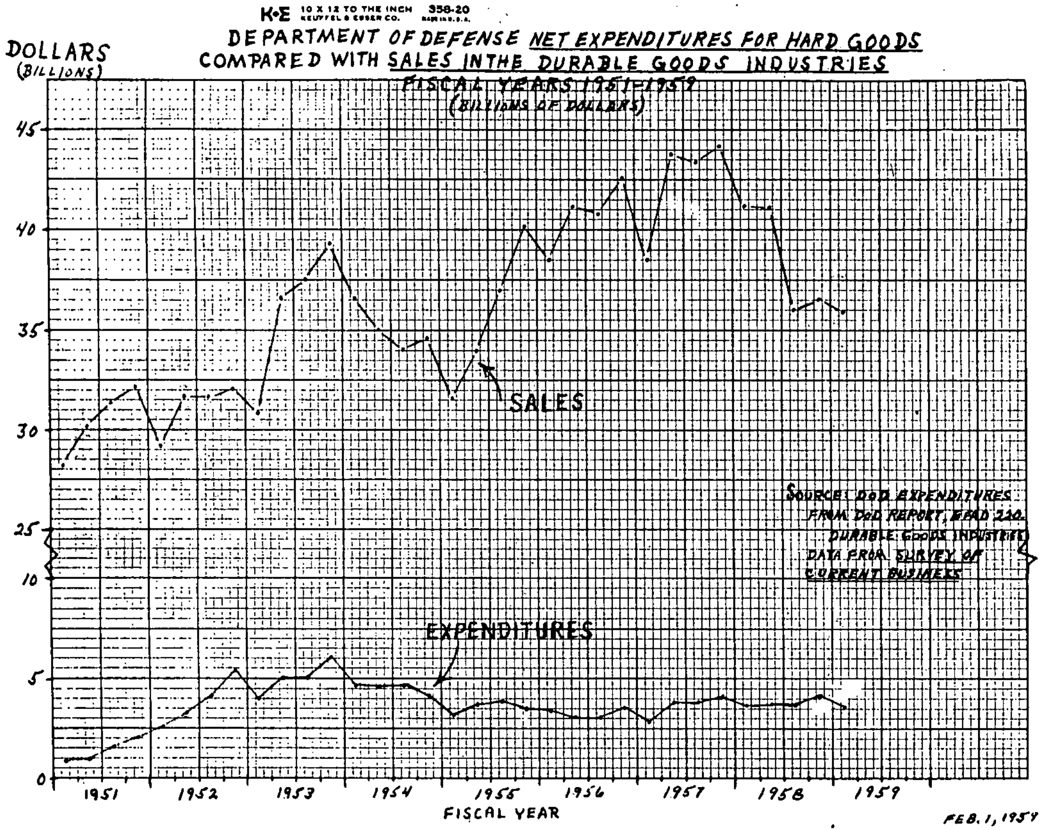
*Direct, reimbursable, and total obligations, fiscal years 1958–60*

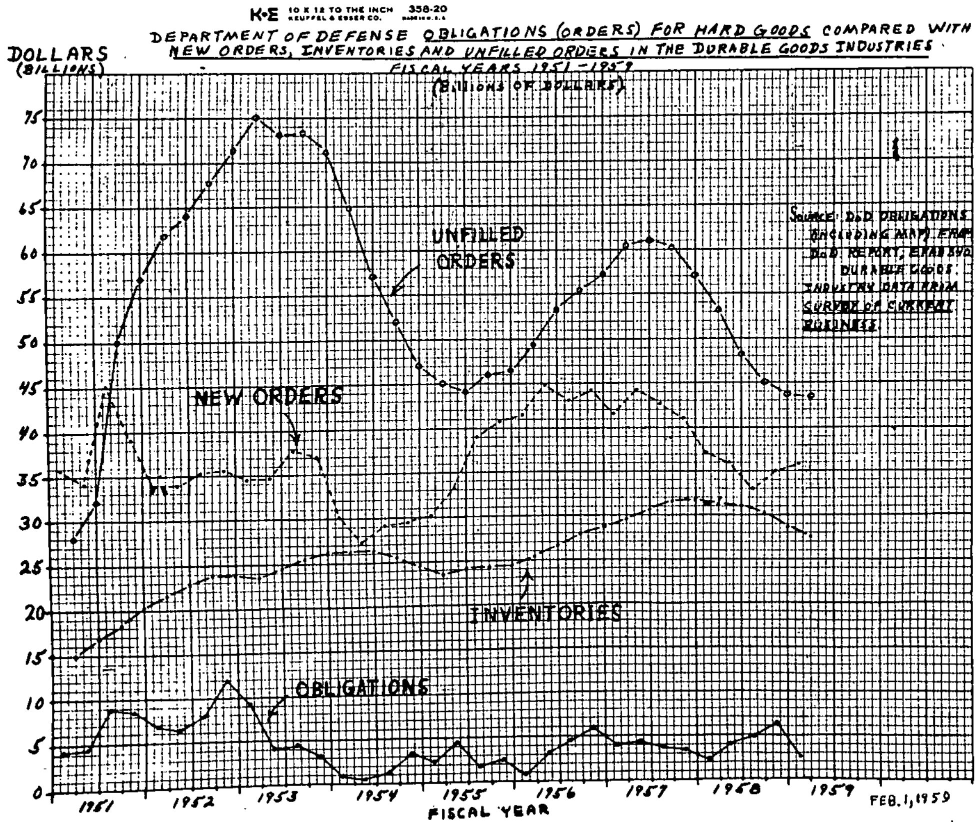
[Millions of dollars]

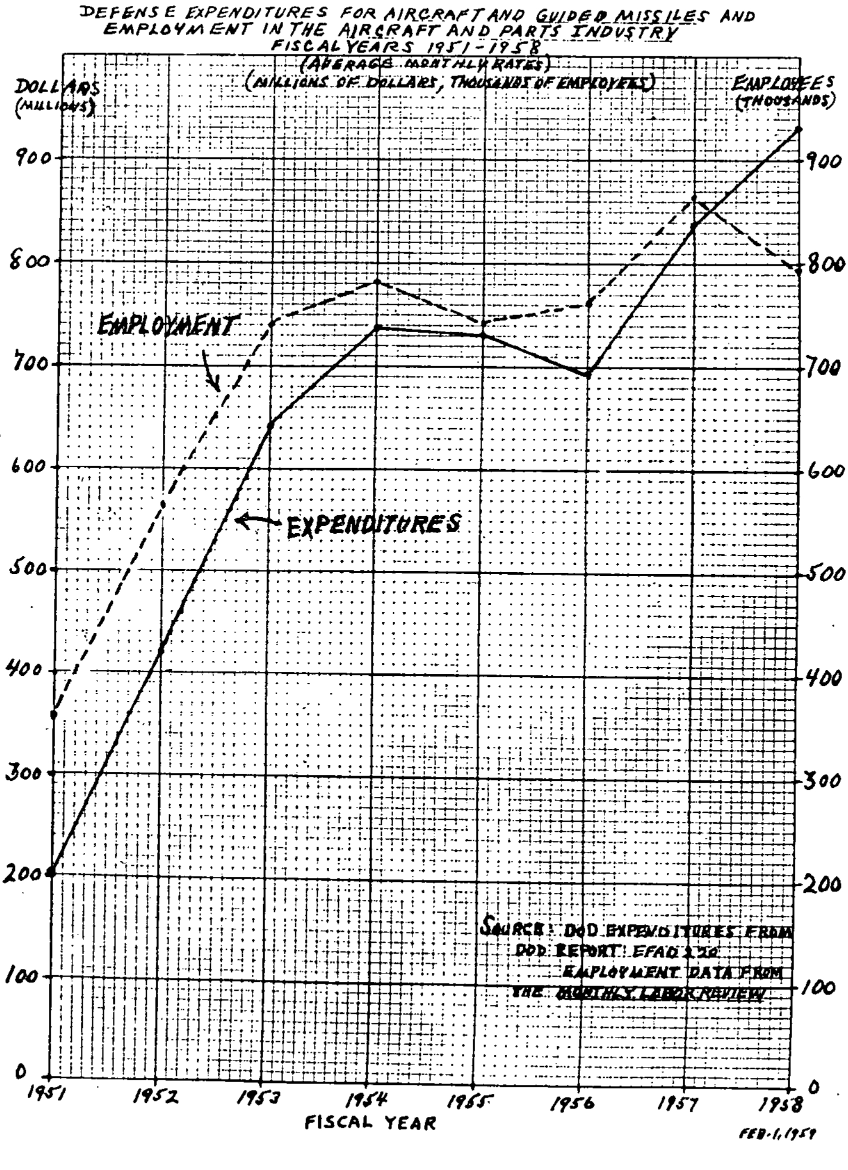
| Title | Fiscal year 1958 | | | Fiscal year 1959 | | | Fiscal year 1960 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Direct | Reimbursable | Total | Direct | Reimbursable | Total | Direct | Reimbursable | Total |
| Operating costs | 21,749 | 1,073 | 22,822 | 22,247 | 1,332 | 23,579 | 22,477 | 1,231 | 23,708 |
| Military personnel | 11,548 | 246 | 11,794 | 11,940 | 265 | 12,205 | 11,965 | 264 | 12,229 |
| Active Forces | 10,386 | 242 | 10,628 | 10,666 | 263 | 10,929 | 10,642 | 261 | 10,903 |
| Reserve Forces | 601 | 4 | 605 | 629 | 2 | 631 | 608 | 3 | 611 |
| Retired pay | 561 | | 561 | 645 | | 645 | 715 | | 715 |
| Operation and maintenance | 10,201 | 827 | 11,028 | 10,307 | 1,067 | 11,374 | 10,512 | 967 | 11,479 |
| Capital costs | 19,292 | 1,098 | 20,390 | 21,188 | 1,275 | 22,463 | 20,231 | 482 | 20,713 |
| Procurement | 15,155 | 1,053 | 16,208 | 15,675 | 1,162 | 16,837 | 14,919 | 378 | 15,297 |
| Aircraft | 8,345 | 234 | 8,579 | 7,327 | 208 | 7,535 | 6,795 | 76 | 6,871 |
| Missiles | 3,123 | 460 | 3,583 | 4,103 | 423 | 4,526 | 3,764 | 145 | 3,909 |
| Ships | 1,760 | 4 | 1,764 | 1,930 | 84 | 2,014 | 1,719 | 15 | 1,734 |
| Other | 1,927 | 355 | 2,282 | 2,315 | 447 | 2,762 | 2,641 | 142 | 2,783 |
| Research, development, test, and evaluation | 2,503 | 35 | 2,538 | 3,522 | 98 | 3,620 | 3,722 | 89 | 3,811 |
| Military construction | 1,634 | 10 | 1,644 | 1,991 | 15 | 2,006 | 1,589 | 15 | 1,604 |
| Active Forces | 1,556 | 10 | 1,566 | 1,925 | 15 | 1,940 | 1,519 | 15 | 1,534 |
| Reserve Forces | 78 | | 78 | 66 | | 66 | 70 | | 70 |
| Total | 41,042 | 2,170 | 43,212 | 43,435 | 2,607 | 46,042 | 42,707 | 1,713 | 44,420 |

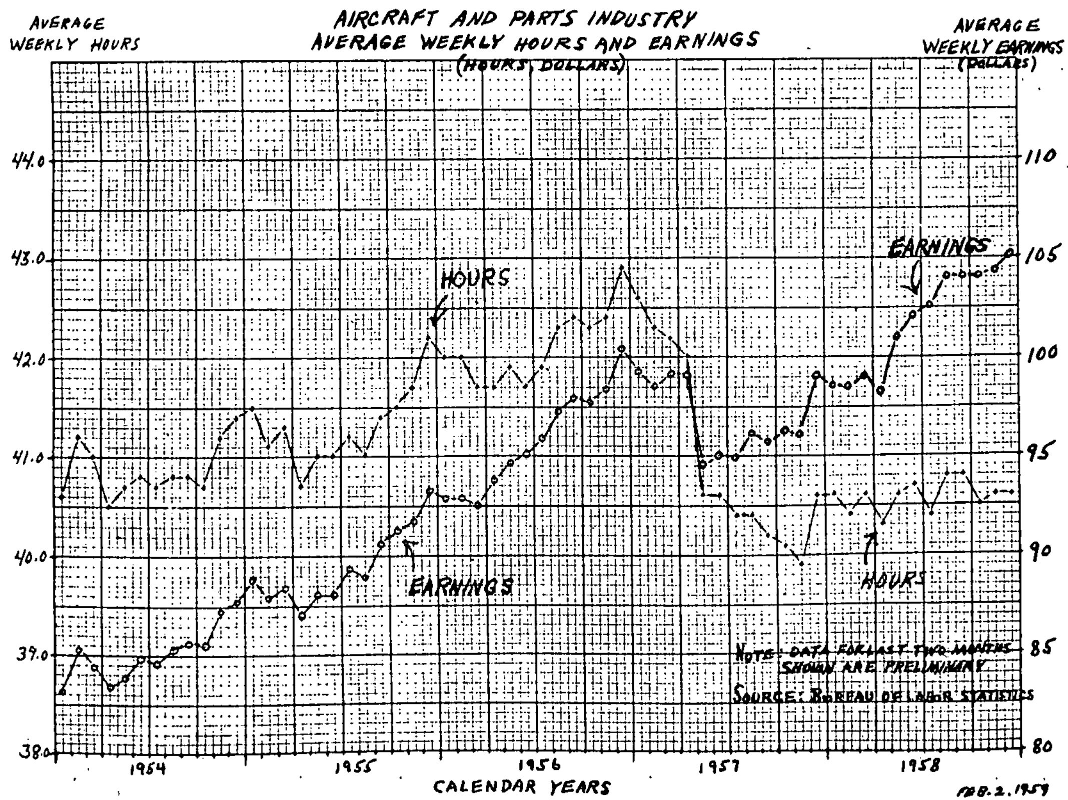
NOTE.—Fiscal year 1959 includes proposed supplemental of $294,200,000.

36379—59——48

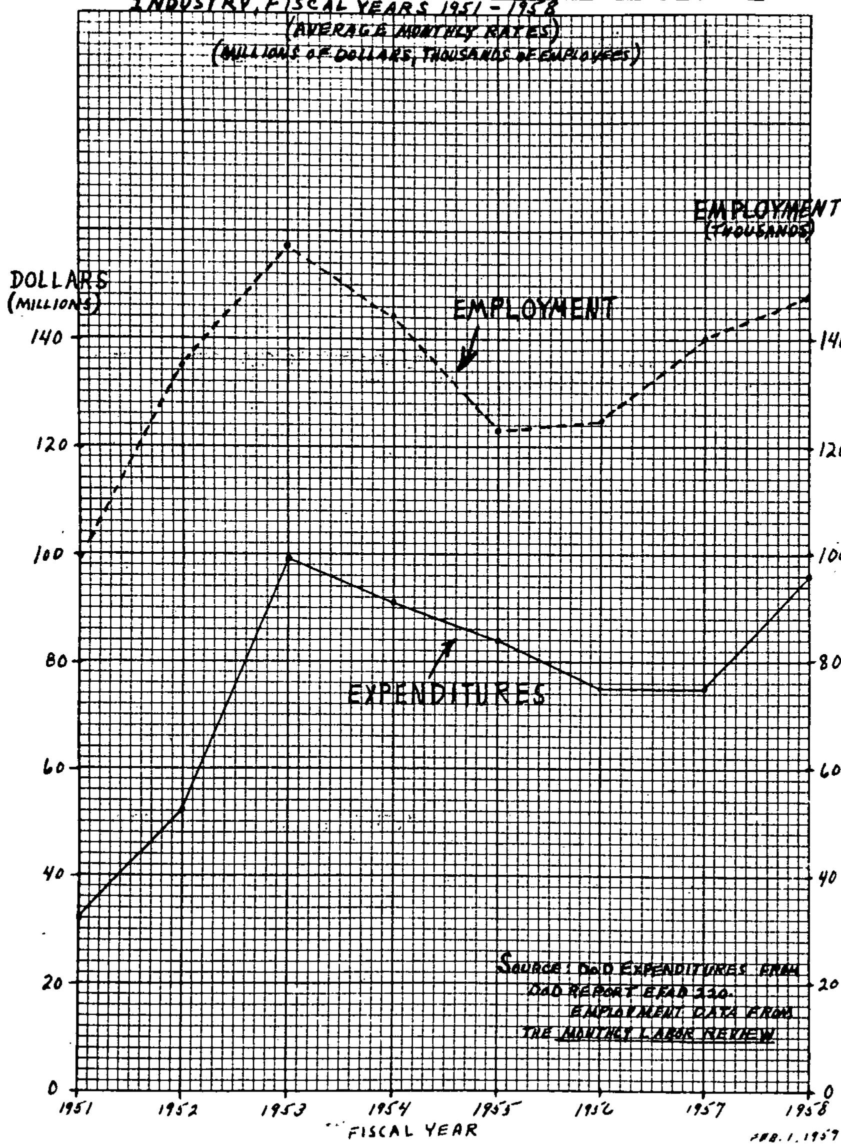

K+E 10 X 12 TO THE INCH 358-20
DEPARTMENT OF DEFENSE NET EXPENDITURES FOR HARD GOODS
COMPARED WITH SALES IN THE DURABLE GOODS INDUSTRIES
FISCAL YEARS 1951-1959
(BILLIONS OF DOLLARS)
DOLLARS (BILLIONS)
45
40
35
30
25
10
5
0
SALES
EXPENDITURES
SOURCE: DoD EXPENDITURES FROM DoD REPORT, EFAD 220.
DURABLE GOODS INDUSTRIES DATA FROM SURVEY OF CURRENT BUSINESS
1951
1952
1953
1954
1955
1956
1957
1958
1959
FISCAL YEAR
FEB. 1, 1959

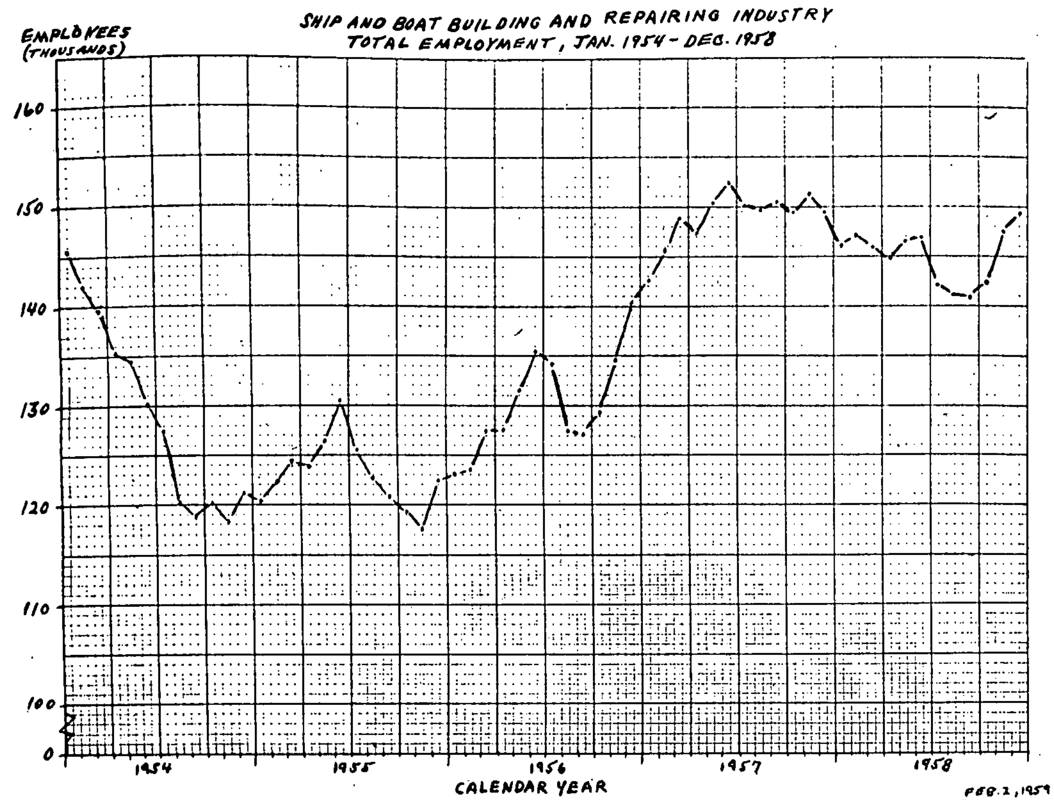

K+E 10 X 12 TO THE INCH 358-20
DEPARTMENT OF DEFENSE OBLIGATIONS (ORDERS) FOR HARD GOODS COMPARED WITH
NEW ORDERS, INVENTORIES AND UNFILLED ORDERS IN THE DURABLE GOODS INDUSTRIES
FISCAL YEARS 1951-1959
(Billions of Dollars)
DOLLARS
(BILLIONS)
75
70
65
60
55
50
45
40
35
30
25
20
15
10
5
0
UNFILLED ORDERS
NEW ORDERS
INVENTORIES
OBLIGATIONS
Source:
1951
1952
1953
1954
1955
1956
1957
1958
1959
FISCAL YEAR
FEB. 1, 1959


DEFENSE EXPENDITURES FOR AIRCRAFT AND GUIDED MISSILES AND
EMPLOYMENT IN THE AIRCRAFT AND PARTS INDUSTRY
FISCAL YEARS 1951-1958
(AVERAGE MONTHLY RATES)
(MILLIONS OF DOLLARS, THOUSANDS OF EMPLOYEES)
DOLLARS (MILLIONS)
EMPLOYEES (THOUSANDS)
900
800
700
600
500
400
300
200
100
0
EMPLOYMENT
EXPENDITURES
SOURCE: DOD EXPENDITURES FROM
DOD REPORT EFAD
EMPLOYMENT DATA FROM
THE MONTHLY LABOR REVIEW
1951
1952
1953
1954
1955
1956
1957
1958
FISCAL YEAR
FEB. 1, 1959

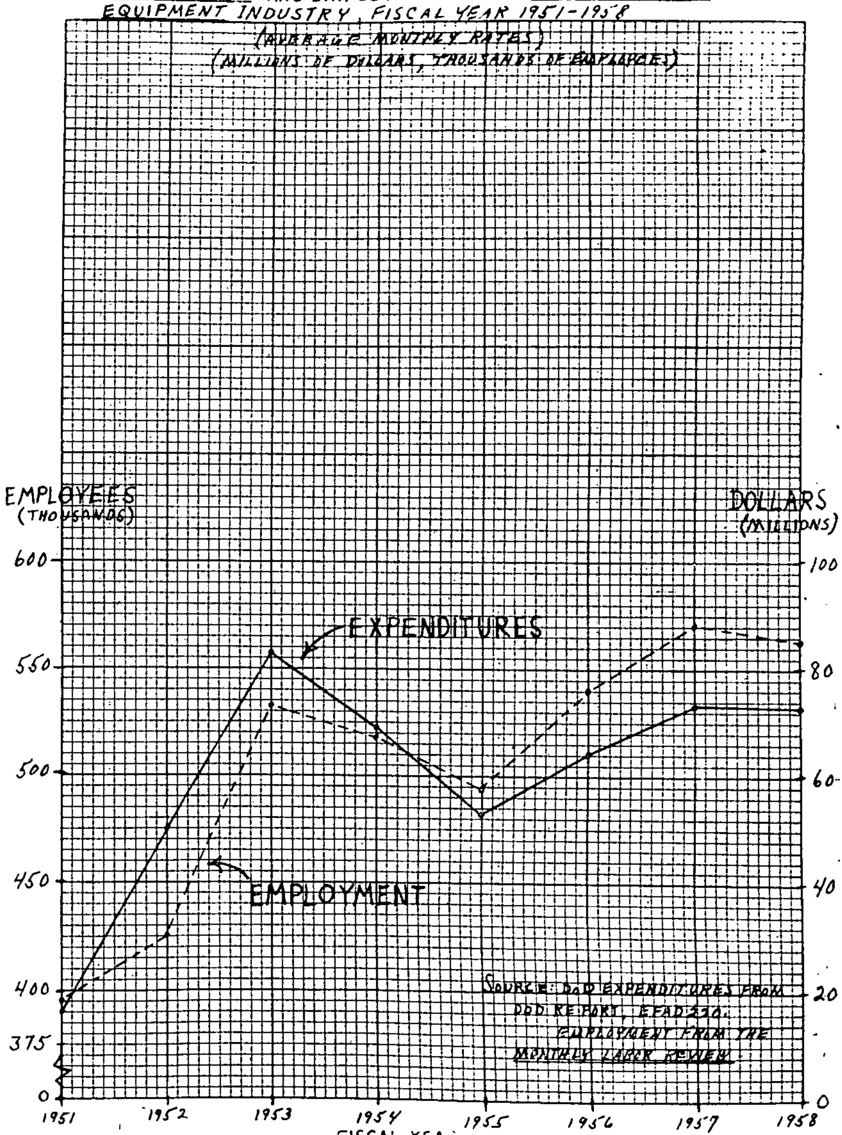

AIRCRAFT AND PARTS INDUSTRY
AVERAGE WEEKLY HOURS AND EARNINGS
(HOURS, DOLLARS)
AVERAGE WEEKLY HOURS
AVERAGE WEEKLY EARNINGS (DOLLARS)
44.0
43.0
42.0
41.0
40.0
39.0
38.0
110
105
100
95
90
85
80
HOURS
EARNINGS
EARNINGS
HOURS
NOTE: DATA FOR LAST TWO MONTHS SHOWN ARE PRELIMINARY
SOURCE: BUREAU OF LABOR STATISTICS
1954
1955
1956
1957
1958
CALENDAR YEARS
FEB. 2. 1959

DEFENSE EXPENDITURES FOR SHIPS AND HARBOR CRAFT AND EMPLOYMENT IN THE SHIP AND BOAT BUILDING AND REPAIRING INDUSTRY, FISCAL YEARS 1951 - 1958
(AVERAGE MONTHLY RATES)
(MILLIONS OF DOLLARS, THOUSANDS OF EMPLOYEES)

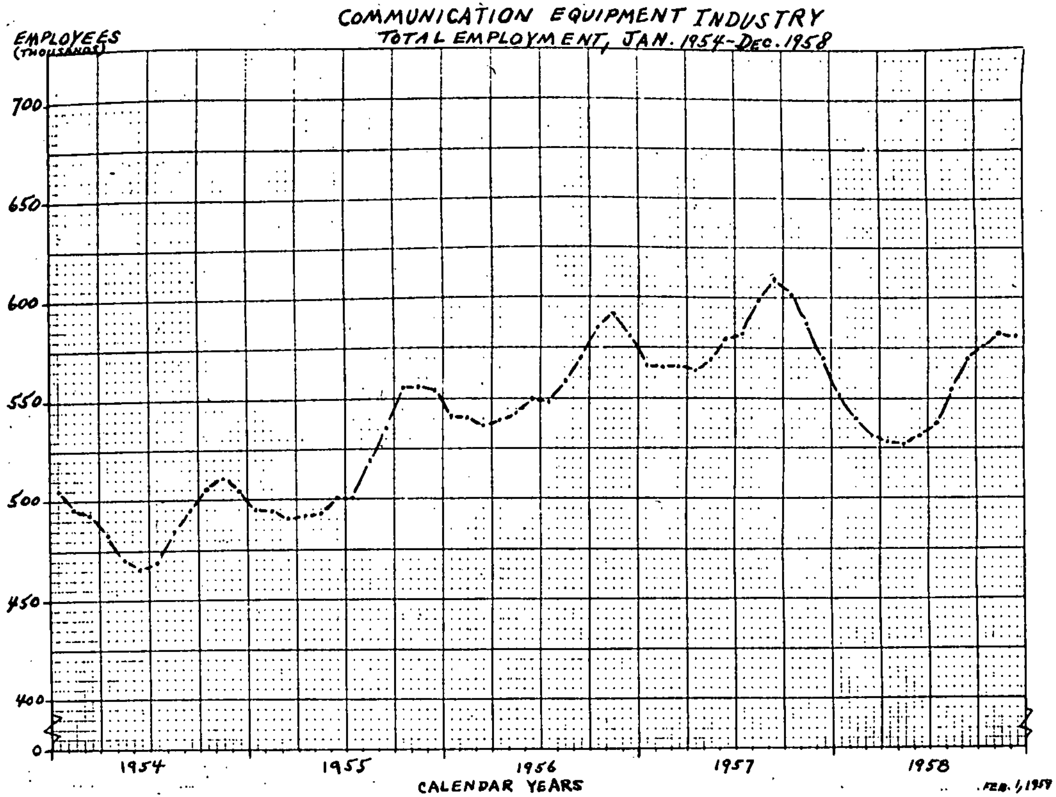


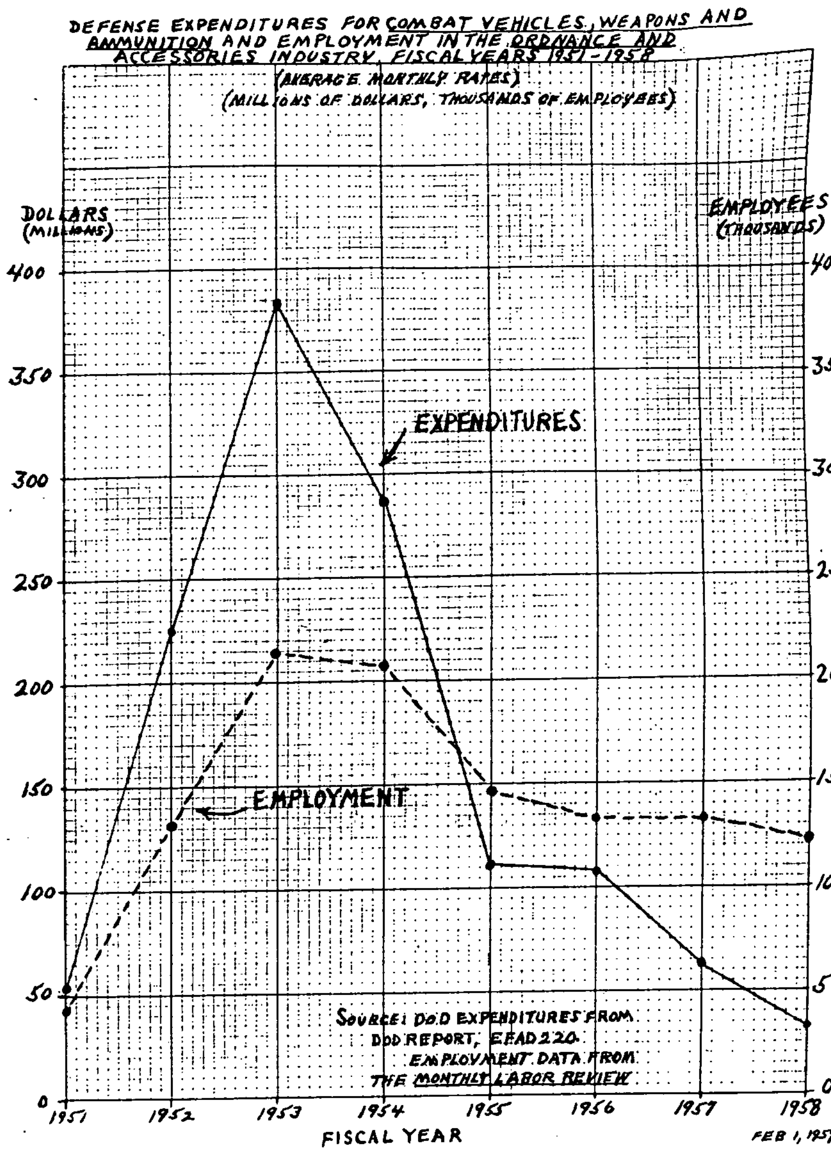

SHIP AND BOAT BUILDING AND REPAIRING INDUSTRY
TOTAL EMPLOYMENT, JAN. 1954 - DEC. 1958
EMPLOYEES (THOUSANDS)
160
150
140
130
120
110
100
0
1954
1955
1956
1957
1958
CALENDAR YEAR
FEB. 2, 1959

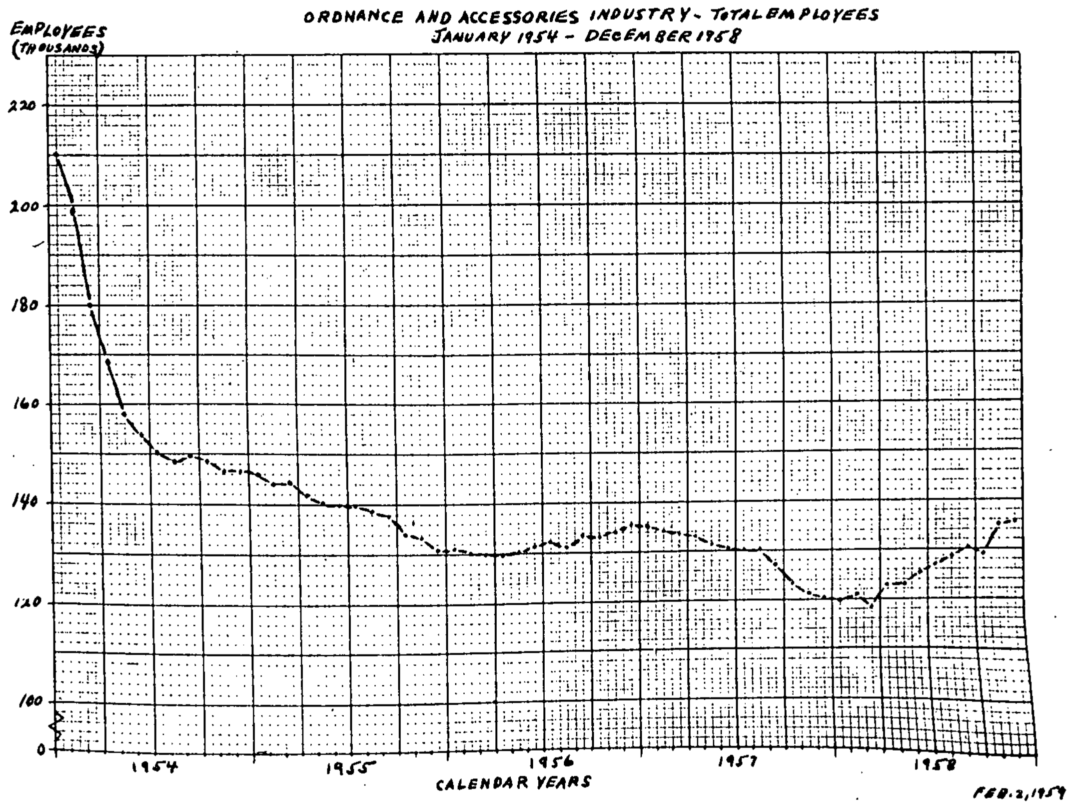
DEPARTMENT OF DEFENSE EXPENDITURES FOR ELECTRONICS AND COMMUNICATIONS AND EMPLOYMENT IN THE COMMUNICATIONS EQUIPMENT INDUSTRY, FISCAL YEAR 1951-1958
(AVERAGE MONTHLY RATES)
(MILLIONS OF DOLLARS, THOUSANDS OF EMPLOYEES)

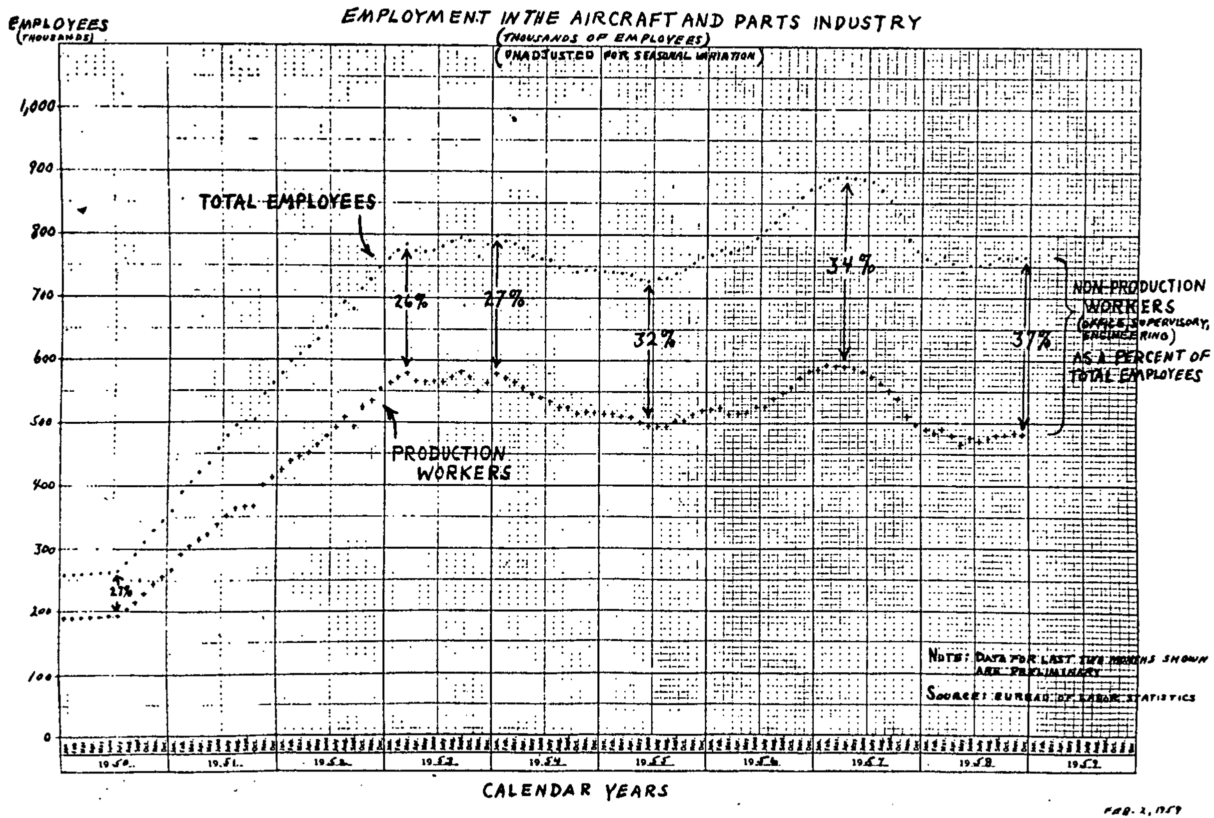



FEB. 1, 1959


COMMUNICATION EQUIPMENT INDUSTRY
TOTAL EMPLOYMENT, JAN. 1954-DEC. 1958
EMPLOYEES (THOUSANDS)
700
650
600
550
500
450
400
0
1954
1955
1956
1957
1958
CALENDAR YEARS
FEB. 1, 1959


DEFENSE EXPENDITURES FOR COMBAT VEHICLES, WEAPONS AND AMMUNITION AND EMPLOYMENT IN THE ORDNANCE AND ACCESSORIES INDUSTRY, FISCAL YEARS 1951-1958
(AVERAGE MONTHLY RATES)
(MILLIONS OF DOLLARS, THOUSANDS OF EMPLOYEES)
DOLLARS (MILLIONS)
EMPLOYEES (THOUSANDS)
400
350
300
250
200
150
100
50
0
EXPENDITURES
EMPLOYMENT
SOURCE: DOD EXPENDITURES FROM DOD REPORT, EFAD 220.
EMPLOYMENT DATA FROM THE MONTHLY LABOR REVIEW
1951
1952
1953
1954
1955
1956
1957
1958
FISCAL YEAR
FEB 1, 1957


ORDNANCE AND ACCESSORIES INDUSTRY - TOTAL EMPLOYEES
JANUARY 1954 - DECEMBER 1958
EMPLOYEES (THOUSANDS)
220
200
180
160
140
120
100
0
1954
1955
1956
1957
1958
CALENDAR YEARS
FEB. 2, 1959


EMPLOYMENT IN THE AIRCRAFT AND PARTS INDUSTRY
(THOUSANDS OF EMPLOYEES)
(UNADJUSTED FOR SEASONAL VARIATION)
EMPLOYEES (THOUSANDS)
1,000
900
800
700
600
500
400
300
200
100
0
TOTAL EMPLOYEES
PRODUCTION WORKERS
27%
26%
27%
32%
34%
37%
NON-PRODUCTION WORKERS (OFFICE, SUPERVISORY, ENGINEERING)
AS A PERCENT OF TOTAL EMPLOYEES
NOTE: DATA FOR LAST TWO MONTHS SHOWN ARE PRELIMINARY
SOURCE: BUREAU OF LABOR STATISTICS
1950
1951
1952
1953
1954
1955
1956
1957
1958
1959
CALENDAR YEARS
FEB. 3, 1959

The CHAIRMAN. You have been very courteous and very patient, Mr. McNeil. We want to thank you.

Mr. McNEIL. Thank you very much.

The CHAIRMAN. We have already published a supplemental report on material concerning prices. There has been a further memorandum prepared on the subject, so I ask unanimous consent to insert at this time the memorandum from Mr. Means.

(The memorandum referred to follows:)

STATEMENT BY DR. GARDINER C. MEANS SUBMITTED TO THE JOINT ECONOMIC COMMITTEE FEBRUARY 16, 1959

Mr. Chairman and members of the Joint Economic Committee, I appreciate this opportunity to comment on the program for economic growth and stability contained in the Economic Report of the President. I am particularly concerned to do so because evidence I have available, some of which has already been introduced into your record, suggests that the President's program is based on a false conception of the twin problems of achieving full employment and preventing inflation.

First, let me discuss the matter of inflation. There are three types of inflation that need to be distinguished. First there is the classical type of inflation in which there is too much money chasing too few goods. This is a demand or monetary inflation. I believe there is general agreement among economists that if you start with full employment, the effect of an unbalanced budget and a loose monetary policy is to generate this kind of inflation. Also I believe there is general agreement that, under normal circumstances, a balanced budget and a tight money policy can prevent this type of inflation. This was the kind of inflation we had after the Second World War and again in the Korean war. Also there is a good deal of evidence that these classical inflations were over by 1953 and that by then the prices of commodities at the wholesale level had in very large measure adjusted to the new price level.

A second type of inflation is the rise of market-dominated prices in a recovery from a recession or depression. This type of inflation is often called a reflation because, unlike a monetary inflation which is harmful, it is a normal and necessary part of the process of economic recovery. Such a reflation does not involve a rise, or as much of a rise, in the inflexible administered prices since they do not usually drop as much as market-dominated prices in a recession. Of course, a balanced budget and a tight money policy could stop such a rise of market-dominated prices but only by stopping the recovery and allowing unemployment to remain high.

The third type of inflation has been called an administrative inflation and involves a rise in prices in the more concentrated industries where there is a considerable area of discretion within which pricing policy can be made. Such pricing power clearly exists in such concentrated industries as steel and automobiles. It could also exist where markets are local and a few producers dominate the market. If this type of inflation occurs by itself, it involves a specialized price rise with the administration-dominated prices rising while market-dominated prices rise little or even fall. Such an administrative inflation could result from excessive wage increases or from business efforts to increase profit margins. But this kind of inflation does not come from a general excess of demand and it cannot be halted by contracting demand except by creating unemployment. Indeed, there is some question whether even a very sizable amount of unemployment could prevent an administrative inflation as I will show below. Control of this type of inflation by a balanced budget and tight money can only succeed through high unemployment and may not succeed even then.

The relation between these three types of inflation should be noted. Classical inflation and reflation are, by their nature, exclusive since a classical inflation starts with full employment while reflation ends with full employment. On the other hand, an administrative inflation can accompany either or even occur when there is a general deflation in progress.

In recent testimony before the Senate Antitrust and Monopoly Subcommittee under the chairmanship of Senator Kefauver, I presented a set of charts which help to emphasize the difference between a classical inflation and an administrative inflation. I should like to introduce those charts here, though two of them have already been introduced into your record by Mr. Reuther.

The first two charts concern the period of inflation following the Second World War and the start of the Korean war. The inflation of this period was classical in its source, with too much demand seeking too few goods. Also it was classical in its results—a more or less general lift in the price level. This can be seen in chart I which shows the percentage increase from 1942 to 1953 in each of the commodity groups composing the BLS wholesale price index.

Before discussing the chart I want to say a word about why I selected the period from 1942 to 1953 as the period of the war inflations. I started with 1942 because the reflation from the great depression of the 1930's was not complete until then. In 1940 we had 8 million unemployed and in 1941 we still averaged 5.5 million unemployed. By early 1942, we had virtually full employment and the wholesale price index had just returned to the level it held in 1926–29 before the depression. For the end of the inflation period, I selected 1953 which was 2 years after the peak of the war inflation had been reached and the first of 2½ years of relative stability in the wholesale price index. By that time, commodity prices had recovered from most of the distortions arising from the process of inflation itself.

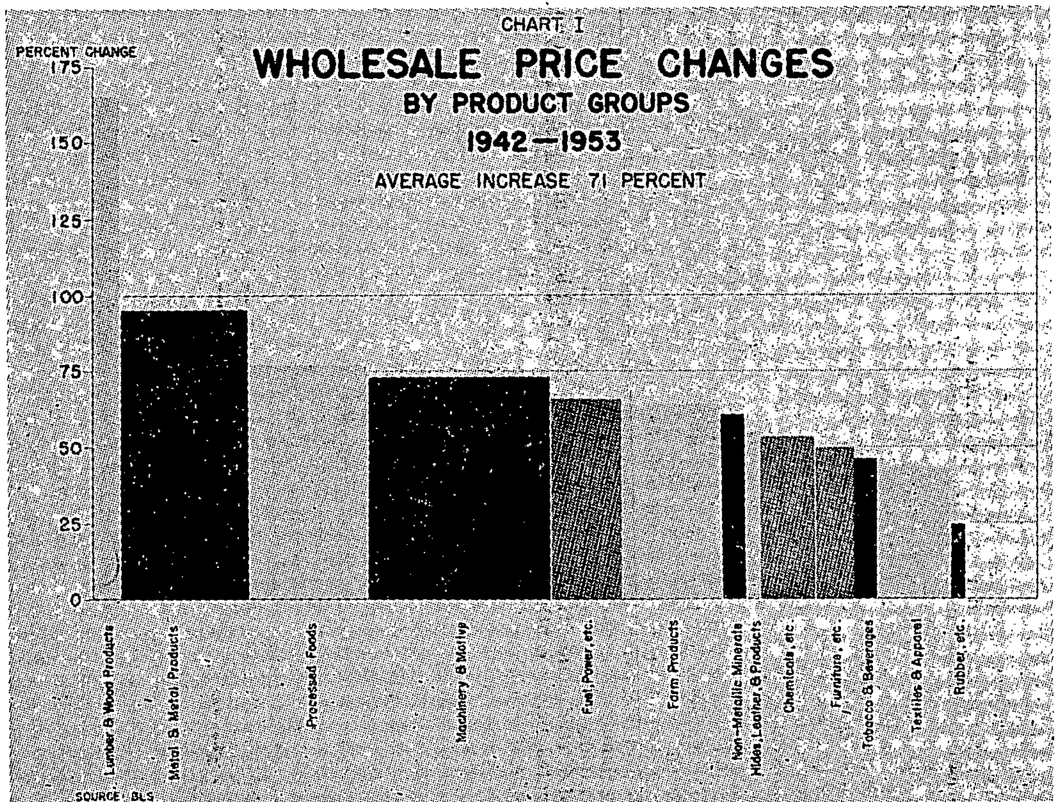


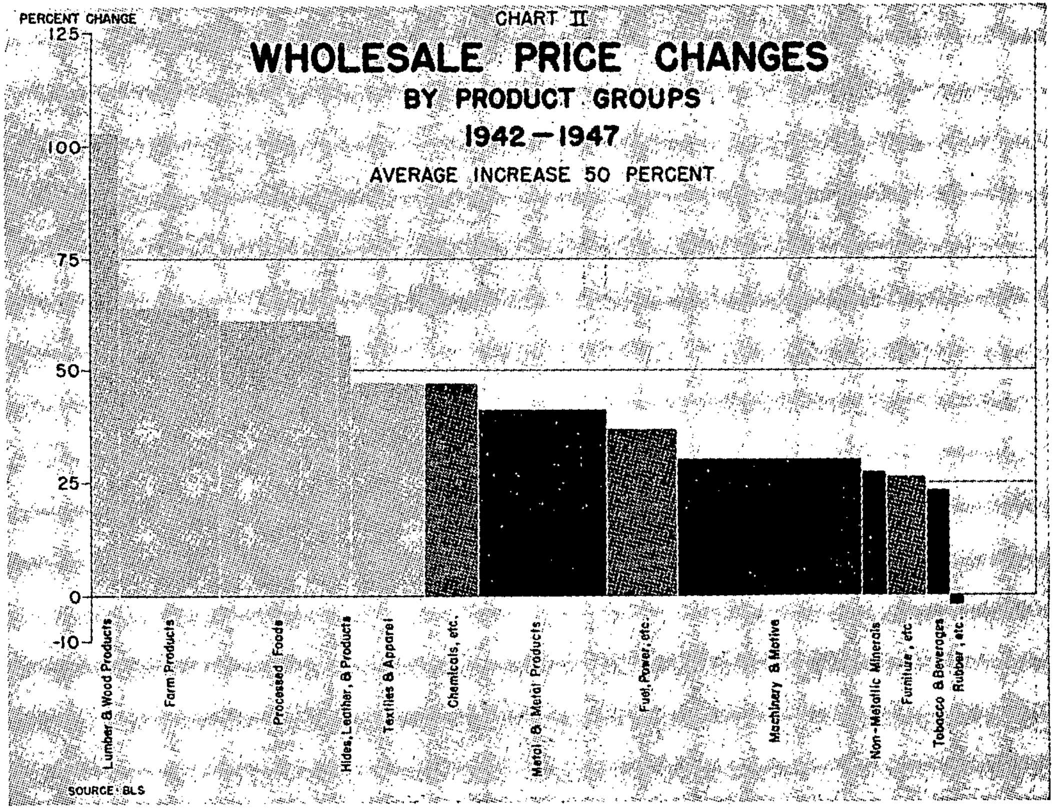
CHART I
WHOLESALE PRICE CHANGES
BY PRODUCT GROUPS
1942—1953
AVERAGE INCREASE 71 PERCENT
PERCENT CHANGE
175
150
125
100
75
50
25
0
Lumber & Wood Products
Metal & Metal Products
Processed Foods
Machinery & Motive
Fuel, Power, etc.
Farm Products
Non-Metallic Minerals
Hides, Leather, & Products
Chemicals, etc.
Furniture, etc.
Tobacco & Beverages
Textiles & Apparel
Rubber, etc.
SOURCE: BLS

In chart I, each price group in the BLS wholesale price index is represented by a column. The height of the column indicates the precent price increase from 1942 to 1953. The width of the column indicates the relative weight of the group in the wholesale price index. The area of the column indicates the contribution each group made to the rise in the wholesale price index.

The first thing to notice in chart I is the relatively general character of this classical inflation. With the exception of the extremes of lumber at one end and rubber at the other, there is a considerable similarity in the price movement. Seventy percent of the groups by weight rose between 49 and 77 percent. This is very much the result to be expected from a typical classical inflation. The difference in percentage increase for different groups presumably reflect the special conditions of supply and demand affecting each group, in addition to the general inflationary forces operating on all groups. Indeed these differences involve the kind of relative price adjustments which could be expected in the absence of inflation.

A second thing to notice is that there is no tendency for the administration dominated prices of concentrated industries to behave differently from the market dominated prices of the nonconcentrated industries. The black columns in the chart represent price groups in which administration dominated prices are in heavy predominance; the light gray, those in which market dominated prices prevail; and the dark gray, those with a more equal mixture of both types. As can be seen, some of the black groups went up less than average, others more. Some of the light gray went up less, some more than average. There is no evidence here of a significant difference in the behavior of the market dominated and the administration dominated prices. This further emphasizes the general character of this classical inflation so far as the end results are concerned.

When we look at the process of inflation, however, we find a quite unclassical difference in behavior between market and administration dominated prices. In the beginning of a monetary inflation, market dominated prices tend to rise more rapidly while administration dominated prices lag well behind. Then, in a period of readjustment, market dominated prices fall back while administration dominated prices continue to rise until the two groups are more nearly in balance. The first stage in this process is shown in chart II. This chart does



PERCENT CHANGE
CHART II
WHOLESALE PRICE CHANGES
BY PRODUCT GROUPS
1942—1947
AVERAGE INCREASE 50 PERCENT
125
100
75
50
25
0
-10
Lumber & Wood Products
Farm Products
Processed Foods
Hides, Leather, & Products
Textiles & Apparel
Chemicals, etc.
Metal & Metal Products
Fuel, Power, etc.
Machinery & Motive
Non-Metallic Minerals
Furniture, etc.
Tobacco & Beverages
Rubber, etc.
SOURCE: BLS


36379—50——49

for the period 1942–47 what chart 1 does for the whole period. As can be seen, the price indexes for the market dominated groups as a whole rose much more rapidly than the price indexes of the more concentrated industries. Thus, the behavior of administration dominated prices helped to slow up the classical inflation rather than to intiate it. Only in the later stages did they catch up. This differential behavior in a classical inflation needs to be emphasized because it is so different from the differential behavior of these two groups of prices in the more recent inflation.

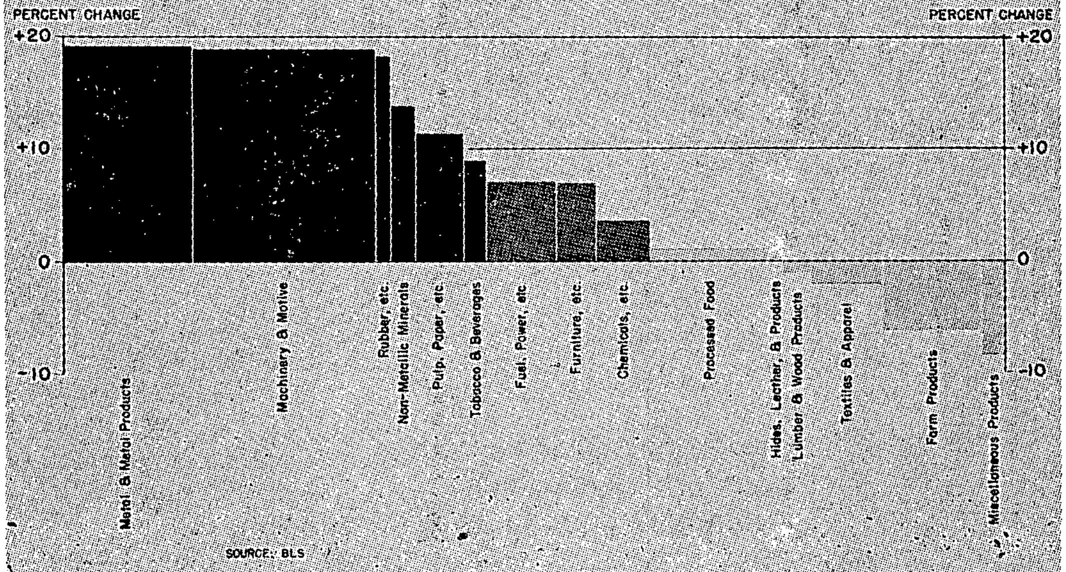
Charts III and IV shows the same kind of analysis for the inflation since 1953. Chart III shows the changes in prices from 1953 to 1957 and chart IV shows changes from 1953 to October 1958, the most recent date for which I had data at the time the charts were prepared. The year 1953 rather than the first half of 1955 was used as the starting point because there was a considerable amount of administrative inflation between those two periods which was covered up in the wholesale price index by the fact that reflation from the 1954 depression was not complete until the middle of 1955. This is clearly shown in the following table which indicates the percent price change for the 15 groups composing the wholesale index from the average for 1953 to the average for the first 6 months of 1955. The italicized categories are the black categories of the chart and represent the administration dominated groups while those quoted are the dark gray categories representing mixed groups:

| *Commodity group* | *Percent change, 1953 to 1st half of 1955* |
|---|---|
| *Rubber and rubber products* | +11 |
| *Tobacco manufactures and bottle beverages* | +5 |
| *Metal and metal products* | +4 |
| *Nonmetallic minerals* | +3½ |
| *Machinery and motive products* | +3 |
| Lumber and lumber products | +1½ |
| "Chemicals and allied products" | +1 |
| *Pulp, paper, and allied products* | +1 |
| "Furniture and other household durables" | +1 |
| "Fuel, power, and lighting materials" | −1½ |
| Processed food | −2 |
| Textile products and apparel | −2 |
| Miscellaneous products | −4 |
| Farm products | −4½ |
| Hides, skins, leather, and leather products | −6 |

CHART III

# WHOLESALE PRICE CHANGES
## BY PRODUCT GROUPS
## 1953—1957

AVERAGE INCREASE 6.8 PERCENT



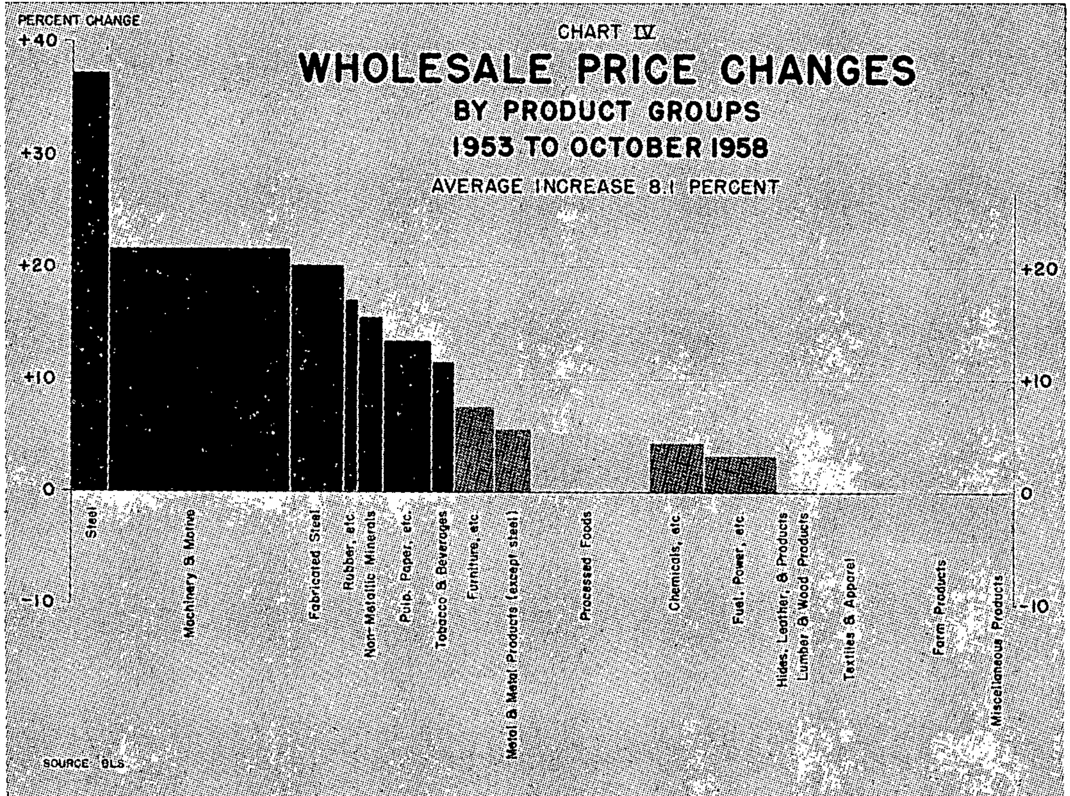


CHART IV
WHOLESALE PRICE CHANGES
BY PRODUCT GROUPS
1953 TO OCTOBER 1958
AVERAGE INCREASE 8.1 PERCENT
PERCENT CHANGE
+40
+30
+20
+10
0
-10
Steel
Machinery & Motive
Fabricated Steel
Rubber, etc.
Non-Metallic Minerals
Pulp, Paper, etc.
Tobacco & Beverages
Furniture, etc.
Metal & Metal Products (except steel)
Processed Foods
Chemicals, etc.
Fuel, Power, etc.
Hides, Leather, & Products
Lumber & Wood Products
Textiles & Apparel
Farm Products
Miscellaneous Products
SOURCE: BLS.

In this recession and recovery period, all six of the administration-dominated groups rose, five of them substantially while all but one of the market-dominated groups were below their 1953 level, three of them substantially. This suggests that the administrative inflation was in operation even between 1953 and the first half of 1955.

In this connection, I would call your attention to the chart on page 11 of the "Economic Report of the President" which uses the same base year 1953 and shows the more or less continuous rise of the prices of manufactured products.

The story told by charts III and IV is clear. In the price increase from 1953 to 1957, shown in chart III, the six administration-dominated groups rose most, the three mixed groups rose to an intermediate degree and the market-dominated groups rose little or actually fell. In chart IV, the comparison has been extended to October 1958, and also the "Metal and metal products" group has been broken into "Semifinished and finished steel"; "Fabricated steel"; and "Metal and metal products (except steel)," in order to bring out the important role played by steel prices in this period. Again the evidence clearly points to an administrative, not a classical, inflation.

The same differential phenomenon appears in the 1957-58 recession. The table below compares price changes from the second quarter of 1957 before the sharp recession began to the second quarter of 1958 when industrial production reached its lowest point. The analysis is limited to industrial products since, as the "Economic Report" points out, the prices of farm and food products reflect the sizable contraction in the supply of certain farm products, notably a short supply of fresh fruit and vegetables, due to bad weather conditions and the short supply of cattle. The "Metal and metal products" group has been divided as in chart IV.

| *Price change* | *2d quarter 1957 to 2d quarter 1958* |
|---|---|
| Miscellaneous | +7.2 |
| *Semifinished and finished steel* | +4.1 |
| *Machinery and motive products* | +3.0 |
| *Tobacco manufacturers and bottled beverages* | +2.7 |
| *Fabricated steel* | +2.7 |
| *Furniture and other household durables* | +1.4 |
| *Pulp, paper, and allied products* | +1.3 |
| *Chemicals and allied products* | +1.2 |
| Hides, skins, leather, and leather products | + .9 |
| *Nonmetallic minerals* | + .3 |
| *Rubber and rubber products* | − .4 |
| Textile products and apparel | −2.0 |
| Lumber and wood products | −3.2 |
| *Fuel, power, and lighting materials* | −6.7 |
| *Metal and metal products (except steel)* | −9.9 |
| Farm products | +7.8 |
| Processed foods | +7.0 |

During this year of recession the industrial price average was very stable. But this stability of the industrial price index was a product of two opposite and offsetting developments, a continued inflation of administration-dominated prices and a deflation of market-dominated prices.

In the partial reflation period since last spring, the administrative inflation appears to have continued along with some reflation of market-dominated industrial prices, a compound movement which has been masked in the wholesale price index by the offsetting fall in the indexes of farm and food products as the particular scarcities of last spring have disappeared.

In the light of these facts, I do not think the "Economic Report of the President" is warranted in stating that, "We may justifiably take satisfaction * * * in the fact that the price level has been reasonably steady of late" (p. 4).

Also I do not accept the statement of the "Economic Report" that, "We may justifiably take satisfaction in the increases already achieved in employment, production, and incomes * * *" (p. 4). Rather, the failure of recovery to continue is a cause for some alarm. Consider the present situation.

As is true of most recessions, a part of the recent recession was a contraction of inventory. In recovery, the reversal of inventory contraction and the rebuilding of inventories is an important factor in contributing to a renewal of demand. But in the partial recovery to date, contraction of inventories had ceased by the middle of the fourth quarter of 1957 and the rebuilding of inventories is likely to be spread over a much longer period. As a result most of the impetus for recovery to be expected from this source has spent itself. Nor is there a sign of greatly expanded private investment. And yet unemployment is significantly greater than it was a year ago and during the last 3 months recovery has just kept pace with the normal growth in the labor force. For 3 months there has been no progress toward the recovery of full employment. Apparently in the presence of the tight money policy the Federal deficit, now running at the annual rate of $6 billion or $7 billion a year, is all that is keeping us from renewed recession and greater unemployment.

This seems to me to pose a major dilemma. The tight money policy was appropriately adopted in 1955 when there was heavy demand for capital goods and if the inflation after early 1956 had been a product of a general excess of demand, the continuance of the tight money policy would have been called for. But a contraction of demand to control an administrative inflation is to limit expansion and force recession. Of course, it would be possible, by limiting demand, to prevent a rise in the average of wholesale prices by forcing down market-dominated prices enough to offset the rise in administration-dominated prices as clearly happened between the second quarter of 1957 and that of 1958. But this is to place the burden of price stability on small business, farmers, and the unemployed. Also the evidence suggests that this does not stop the administrative inflation; it only masks it. And if recovery occurs, the reflation of market-dominated prices will unmask the administrative inflation that has already occurred.

Some people have suggested that, because of administrative inflation, we have to choose between price stability and underemployment on the one hand and full employment and creeping administrative inflation on the other. These do not seem to me to be the only choices. I believe it is well within our power to bring about both full employment and a stable price level. I hope that your committee will examine the problem as I have outlined it and, if you agree with the substance of my conclusions, will undertake to resolve this dilemma. Further, I would like to suggest that, in searching for a solution, you distinguish between (1) temporary measures which would allow the expansion of demand through fiscal and monetary means without engendering further administrative inflation even though such measures might not have longrun value and (2) a more permanent solution which is likely to develop only out of extensive study of the problem and is not likely to be a simple solution if the values of free enterprise and the efficiencies of big business are to be preserved.

The CHAIRMAN. At this point I have three items which I ask unanimous consent to have printed in the record: (1) In response to a request by Senator O'Mahoney (see p. 361) Mr. Frucht who testified on February 3 has submitted an additional statement about legislative measures for increasing price stability. Mr. Frucht's supplemental statement appears below. (2) At the request of Representative Patman (see p. 422) Secretary Anderson has supplied answers to additional questions concerning the proposed exchange of FNMA mortgages for Treasury bonds. (3) Tables and charts which we have had prepared by our staff dealing with the question of price, cost, productivity, labor output and so forth, and bringing up to date material previously published through the year 1957. This material is through 1958.

(The information referred to follows:)

CHAMBER OF COMMERCE OF THE UNITED STATES,
*Washington, D.C., February 23, 1959.*

Senator JOSEPH O'MAHONEY,
*The Joint Economic Committee,*
*The Congress of the United States,*
*Washington, D.C.*

DEAR SENATOR O'MAHONEY: When I testified before the Joint Economic Committee on February 3 last, you requested that I write you in detail to explain my views on the current trend in the price level and on the appropriate legislative measures for increasing price stability. I am happy to comply, though I wish to emphasize that what follows is personal and does not necessarily reflect the position of the U.S. Chamber of Commerce—which was presented to the committee on February 9 by Mr. Walter D. Fackler.

Business firms which administer their prices (perhaps 90 percent of all businesses) do not raise them any faster or in greater proportion in response to increasing demand or costs than do firms subject to perfect (identical product) competition. This conclusion, which appears to hold whether firms have much or little market power, rests on the analysis I previously submitted for the record. Furthermore, I do not find that an objective analysis of the evidence presently available justifies any very sweeping indictment of union wage pressures as major contributors to inflation. (However, I do not mean in the slightest to suggest that excessive market power positions on either side of the collective-bargaining table are not grounds for the most serious public concern.)

In general, I can find no solid basis in either evidence or logic to justify pillorying as "inflation begetters" either business or labor unions. To be sure, we have been subjected to a seemingly endless barrage of conflicting partisan argumentation and assertion to a flow of "fresh new angles," each proving "once and for all" that one or the other side is the true despoiler of our cherished price stability. The spectacle presented by the eagerness with which so many "experts" have publicly indulged in willful and irresponsible playing of the "economic numbers game" would be merely laughable if its effects in public and legislative anxiety and inflation hysteria were not so gravely portentous for public economic policy and for our future as a free nation.

On the basis of the evidence on price-level trends, I can find no objective grounds whatsoever for any serious alarm about inflation. From 1948 to 1958 the average annual compound rate of increase in the Consumer Price Index was only 1¾ percent. As Alvin Hanson has pointed out, this increase can hardly be compared unfavorably with the record of the past 60 years—from 1897 to 1958 the average annual increase in prices was 2⅓ percent. Even during the peaceful prosperity of the Edwardian calm, from 1897 to 1913, the annual increase was 2½ percent. Yet we have done better in the past decade, despite the fact that we fought a war and expended over $400 billion on national security in this period. And the quality of products has improved greatly, although most improvements in quality and increases in product complexity are not taken into account by the price indexes at all.

My perplexity over the basis for current inflation jitters is not reduced by international comparisons. If we look at the evidence for the years 1953–57, we find that, of all the Western European nations, only Germany and little Switzerland can match our price stability record.

Since the most cursory inspection of postwar price trends shows that, far from accelerating, the rate of growth in prices is falling, I cannot even find inflation perils by playing the economist's parlor game of extrapolating the price series.

Despite the fact that postwar increases in prices have clearly been moderate, I would certainly prefer to have a perfectly stable or even a falling price series. Even a 2 percent rise in prices must transfer a good deal of income quite arbitrarily from some people to others. Though the net amount transferred can hardly exceed 2 billion per year, the transfer is primarily at the expense of individuals (primarily pensioners) least able to afford the loss. I therefore would like to inquire further to see why the price level does not show a falling trend.

I believe that postwar price level behavior should primarily be explained in terms of the interacting responses to economic growth by the private economy and government—Federal, State, and local. The key element in this interaction is the fact that growth is normally associated with a great deal of shifting about in the composition of total national demand. Not only do consumer wants shift about among products and services, but also the needs of business and governments change, sometimes quite radically. These demand shifts result from autonomous changes in buyers' preferences and from substitutions inspired by new products and price differentials due to productivity gains. Of these demand changes, only the third is deflationary under the conditions which prevail in our economy.

If economic growth affected all industries in equal proportion, it is unlikely that the price level would rise. Nor would there be upward price pressures if changing demand patterns took place where resources would quickly and easily shift from where they are less wanted to where the need for them increases. Our problem, however, is founded on two basic facts:

(*a*) Labor, the most vital resource of all, tends to be highly immobile in the short run. The movement of unemployed labor from declining industries and localities is subject to lags of greater or lesser duration.

(*b*) Though industries and localities in decline may suffer from heavy unemployment, wage rates are strongly resistant to reductions. So long as wages stay up, prices in such circumstances also tend to hold firm. Wages and prices are highly rigid downward when output falls, but are much more flexible for upward movements in demand.

Labor immobility, which exists even when local unemployment is heavy and other job markets are begging for labor, is a crucial problem in itself, for both the workers involved and the economy. Coupled with the downward rigidity in wages and prices even when unemployment is up, labor immobility retards economic growth and creates an inflationary situation to boot.

If, in a generally prosperous economy, demand shifts from one industry to another, it must tend under conditions of labor immobility and downward wage and price rigidity to increase the price level. Demand-gaining industries, on expanding output, put pressure on the labor markets in which they are located, raising their labor costs and then, in time, their prices. Since wages and prices do not typically fall with equal speed in demand-losing industries, and since unemployed workers tend to remain where they are for considerable periods, the general price level must rise even though total employment in the economy may well be down. If there are many shifts in demand, some reaching significant proportions, there can be considerable upward price pressures, even amidst growing ("structural") unemployment. This set of circumstances may best explain the recession from which we are just recovering. This recession featured a most dramatic shift in consumer demand from heavy durables toward soft goods and services.

The problems inherent in economic change pose particularly troublesome dilemmas to monetary and fiscal policymakers.

Increasing prices due to shifting demands tend to strain the money supply. If the money supply does not expand as prices rise, effective demand in the overall economy may be expected to fall, causing reductions in output and increases in unemployment. This increase in unemployment is not itself "structural," though it is due to structural shifts, since it results from a decline in effective total demand. Increasing the money supply in this case, however, will tend to prevent downward price adjustments and will solidify the now higher price level.

If fiscal policy is dedicated to maintaining "full employment" and if it takes its cues solely from the level of unemployment, without distinguishing between unemployment due to general failure of overall effective demand and structural unemployment, it may only add more demand pressures where demand is already high, while doing little for the unemployment due to labor immobilities. How much the price level might have been pushed up had monetary-fiscal policies been used in 1957 to pump up total demand enough to put Detroit back at full employment is not easy to determine, but the rise would have been a dramatic one.

The picture is not as black as the above implies, however. Some of the upward price pressures inherent in economic change where downward wage-price rigidities and labor immobilities are strong are weakened and may be offset in whole or in part by two other aspects of growth. Labor shortages in sectors of rising demand and labor immobilities in areas of decline are relaxed by the growth and replacement of the labor force. While the labor force is growing, many workers are also leaving it, through death, retirement, and so forth. New entrants to the labor force tend to go into industries and areas of expanding demand, while all the workers who permanently leave the labor force in declining industries and regions are not replaced in those labor markets. A second growth factor working to offset price increases is that of increasing productivity. To the extent that productivity gains in particular industries are not wholly absorbed by higher wage costs, they tend over time to lower prices.

In view of the fact that we have had significantly high rates of growth in the postwar period as a whole and many shifts in demand composition, the very moderate trend in prices testifies to the pressure of strong anti-inflationary offsets in the private economy. The record of price stability appears even stronger when we note that over this period Government has increased the deficit by 12 percent and that the money supply has grown faster than output.

A reasonable man might well be inclined to feel that our growing and changing private economy has really done exceedingly well price levelwise in the face of the downward wage-price rigidities, the relative immobility of labor normal in our private economy and a generally willing use of monetary and fiscal policies to inject considerable adrenalin to the economic body.

Shifting of demand composition tends to be inflationary where downward wage-price rigidities and labor immobilities are strong. And such "frictions" exist regardless of whether business market power is strong or weak, whether unions are strong, weak, or nonexistent. It must be doubted, therefore, whether even the most extreme of possible governmental policies, such as breaking all business firms down to the one-plant level or outlawing all unions, could improve matters much in this particular respect.

If the rate of mobility by labor out of declining industries and areas is roughly equal to the rate of increase in demand for labor in gaining industries, productivity gains and labor force growth can hold down the cost-price effects of change—and perhaps even reduce prices. This holds so long as the lag in adjustment of labor does not increase. But for many reasons these two rates will fluctuate, adding or subtracting price pressures. Thus, in a free economy such as ours, we can and should expect to experience sharp changes in the rate of price level increase from time to time. But such relative changes in price pressures are generally not systematic in origin and will not persist over time. Governmental antigrowth policies and programs, however, introduce systematic biases into the system—they systematically retard growth and labor force reallocation. As antichange policies grow in number and in scope, they add more and more systematic inflationary pressure to the system, while at the same time reducing economic growth.

It is passing strange that, of the great number of students, writers, and polemicists who have cooperated in stirring up our current inflation obsession, only a relative few have noticed the inflationary implications of our massive and evergrowing governmental opposition to economic growth and change. To be sure, most economists concerned with particular types of antigrowth, antichange governmental policies have pointed out their inflationary biases. But Congress and the Nation need to see the implications of antichange policies in the large.

Economic growth has two components: (1) Rising income due to increasingly better utilization of given available resources in satisfying our wants as they develop and change over time; and (2) rising income due to increasing amounts of material resources and growth in the labor force.

Of the components of growth, increasing productivity in clearly the one with the most significance for raising our standard of living and the most relevance for our national security as well as for our fundamental social, cultural and political health.

Unhappily, despite the fact that growth is so vitally needed and wanted by all of us, whether liberal or conservative, Congress appears to believe that as a people we also want even more a kind of individual economic security that directly conflicts with the economic changes required for nationwide growth. Growth and change do mean (primarily temporary) losses, adjustments, and sometimes even hardship to some relative few, while in each case the Nation reaps larger gains which, however, may appear small because they are spread out over the rest of society. The gains widely diffuse while the costs are concentrated. Political pressures for special interest legislation to protect the losers are, therefore, often stronger than pressures to safeguard and promote for the Nation the net gains of economic growth. But gains are permanent and build on themselves, while the consequent losses are temporary and overtime would be made up for most losers by the gains accruing from other economic changes. If we view growth only from the standpoint of the short-run interests of particular losers, we may shortsightedly sacrifice much of the bright in their futures, and ours, in order to ameliorate only temporary present aches. Yet, we pass antigrowth legislation in an ever-increasing torrent. This is particularly unfortunate because if we want economic growth as well as protection of losers from growth and change there are ways to achieve protection without so strongly crippling growth—and without putting such pressures on the price level.

Congress could make enormous contributions to the national welfare if it would shift its approach on economic growth from negative to positive. If it acted positively to promote growth and economic freedom there would be greater real security for all of us in the more dynamic economy which would result than in the more sluggish, more inflationary one we get from the negative status quo policy orientation which is so dominant today. Let us look briefly at some of the major types of antigrowth and antichange legislation which we have on the books. Whether or not one agrees with these policies or their specific goals, my point here is that they are adverse to growth and prevent downward price adjustments which would stabilize or reduce the general price level.

(1) AGRICULTURAL PRICE SUPPORT PROGRAMS

In 1959, according to the President's Economic Report, we are expected to spend well over $5 billions on "stabilization" of farm prices and income. This expenditure means less movement of farm labor into other industries and higher farm as well as nonfarm prices than would otherwise prevail. Yet agricultural experts estimate that we could meet our total present food requirements with only 10 to 15 percent of the 7½ million workers now on our farms. While I do not suggest that anything like 6 million or so farmers would jump into the nonfarm labor force if all price supports were lifted, it cannot be denied that the shift of farm labor into more productive employment would go faster. With economic growth under the generally high levels of employment of the postwar period the potential value of the output of each of these 6 million workers must approach $5,000 per year. Thus, we lose the inflation-reducing benefits of eased labor market conditions and a possible addition to our national output of perhaps $30 billion.

Consider, as an alternative to our present inflationary, growth stultifying, and wasteful farm program, the approach suggested by Prof. T. W. Schultz, of the University of Chicago—one of our leading agricultural economists. This approach, which he terms "homesteads in reverse," seeks to use Federal funds to help low income farm workers to leave the farms and raise their standard of living. If we could induce even 1 million of these now wholly unproductive workers to move off the farms into nonfarm labor markets, we could expect a permanent increase in national output of at least $5 billion. By devoting a tenth of the imagination now used in generating agricultural waste to finding appropriate ways for using Federal resources to relocate farmworkers in productive jobs—to provide training and education where necessary and a financial cushion—Congress could undoubtedly clear up most of the farm problem in a few years. And this objective could be achieved at no greater cost than our present "stabilization" appropriations if carefully handled.

(2) IMPORT RESTRICTIONS

Import competition of foreign products in domestic markets has beneficial growth effects similar to those resulting from increases in domestic productivity. Thus, trade restrictions reduce economic growth and hold up many domestic prices. Though, initially, the prospective addition to total real national income resulting from complete abandonment of trade restrictions would not be large, perhaps only 2 to 3 percent, its impact on the price level would probably be significantly larger. Prices are made or highly influenced by changes at the margin of total supply. Furthermore, in the long pull, a large part of the gains from trade would consist of the gains in efficiency in our domestic industries resulting from a much-stepped-up foreign competition. Free trade would thus give us substantial increases in efficiency and real income, while contributing much to the reduction of both the price level and domestic business market power. The potential income we casually toss away through trade restrictions could, if devoted to education, for instance, provide us with an educational establishment beyond the wildest dreams of the most starry-eyed educationist, opening much wider this most vital of all gateways to economic growth as well as social and political excellence.

It may well be true that the American public is willing to pay a substantial price to ease the burden of economic changes upon its victims. But it is highly unclear that the average voter would support antigrowth legislation designed to preserve the status quo if he were made really aware of its costs in higher prices and to his standard of living, present and future. Since the costs of trade restrictions, unlike those involved in direct cash subsidies, do not enter the Federal budget even partly, they do not impose the discipline of taxation offsets on Congress. One may wonder how strong the "national mandate for import barriers" would be if some of their costs were made more visible to the public by the use of domestic cash subsidies to exclude imports instead of tariffs and quotas. And one may further wonder whether, if the public were informed of the alternatives possible, it would prefer an approach to easing the burdens of change which retards growth to ways which would not retard growth or raise prices. Why is so little legislative imagination devoted to easing the burdens of adjustment to change in ways favorable to growth in comparison with that spent on preventing change and growth? One's respect for congressional responsibility and vision is not increased by the adoption by the last Congress of the "defense essentiality" amendment to the Trade Agreements Act. This device cloaks antigrowth policies irrelevantly but effectively in the flag of "defense needs," reducing their visibility to the voter even more than ordinarily.

(3) SOME OTHER MAJOR FORMS OF ANTIGROWTH PRICE-INCREASING LEGISLATION

(*a*) Minimum price fixing in transportation, in oil and minerals, "fair trade" legislation, state milkshed price floors.

(*b*) Depressed areas subsidies (prospective).

(*c*) Interest subsidies or guarantees. These redirect capital resources from where their returns in real income are larger to where they are smaller.

(*d*) Personal income tax biases against risk taking.

(*e*) The tax subsidy of research and development obtained by allowing these costs to be expensed as accrued. This diverts much of our limited scientific resources away from basic research and education and is another instance of our willingness to sacrifice future for temporary gains. This subsidy gives us relatively more minor improvements on known technology and existing products and relatively fewer major innovations in technology and products.

Considering the substantial impact of strong governmental antigrowth policies it is wholly remarkable that the American economy has nevertheless been able to grow during the post-war period at its normal historical pace. The average percentage increase per year in output per man-hour in manufacturing for the period 1909 to 1939 was 3.3 percent. Yet from 1947 to 1953 the rate was 3.4 percent. How much output we have thrown away in the past by programs retarding growth, and how much higher the price level is thereby, can only be conjectured. And we must also take into account the fact that the economic and social climate resulting from a stepped-up growth rate in a free economy must in itself enhance the prospects for future growth.

Even a most moderate reversal of governmental antigrowth policies could well result, therefore, in a stepping-up of the growth rate to the 5 percent so many call for. Such a reversal should give us also the price stability we all desire, and could well give us over time even a moderately falling price level. An all-out legislative reversal in favor of growth coud spark an even higher growth rate. I very much doubt that whatever growth the Soviet can achieve by dint of all-out force and coercion could match the exuberant rates which would be generated by our free economy if the Government would let down its barriers to growth. And this growth would necessarily be accompanied by stable or falling prices. (This would enable pensioners to share in the fruits of progress, from which they are now excluded by the inflationary effects of governmental antichange programs.)

Furthermore, to the extent that Congress feels a mandate to ease the immediate burdens for the victims of change, it can do all it wishes here without retarding change. Implicit in the U.S. Employment Service is an approach to relieving distress from change which at the same time promotes change. Congressional imagination exercised along this line of attack could revolutionize the performance of the American economy and hurl a devastating challenge back in Khrushchev's teeth.

In contrast, the use of price-wage controls to reduce the inflationary effects of governmental policies seems a sorry prescription indeed to me. It means still more "waste, still less economic efficiency, still less growth and satisfaction of our wants and needs. And such a strait-jacketing of our dynamic economic energies can only weaken in the end the muscles of our national security. Furthermore, adoption of peacetime price controls would mean a craven as well as a most unjustified capitulation before the Soviet economic challenge.

If Congress will provide the private economy with a reasonably sound monetary-fiscal environment and will shift its sights from preserving the status quo to promoting economic growth and change there certainly would be no inflation to worry about. The price level would decline and, internationally, the dollar would grow even more in strength and prestige. And the potential cold-war consequences of such behavior are most impressive, indeed. By embracing policies favoring growth and change under free markets, a responsible Congress can thereby give us infinitely more effective and productive "price controls" than any totalitarian economy could possibly establish.

As I stated during the hearings, I find no basis currently for any serious worry about inflation and no justification for even a threat of price or wage controls. But if Congress insists on maintaining or even increasing its inflationary antigrowth policies and in addition it refuses to behave with fiscal responsibility, we must expect some price level rises to result. After all, the heart of the free economy, guiding the allocation of resources in accordance with our wants, is the relative price structure. When governmental programs prevent or deter declines in prices in some economic sectors, prices in other sectors must thereby rise more than otherwise—and increase the price level in the process. If Government increases total demand at the same time, prices must rise even more.

If Government insists on adding inflationary pressures to the economy, then I hold it to be illegitimate for Government to use its own excesses as the excuse for price-wage controls, which explicitly aim to destroy the freedom of relative prices to adjust to the play of changing costs and demands. Free adjustment in relative prices is the essence of free markets, and, as the transmitter of competitive pressures, is the major justification of free enterprise. I can think of no quicker or easier way to deliver us into totalitarianism than for Government to impose inflationary pressures on the free market and then use even the most moderate increases in prices as its justification for destroying economic freedom. If Congress is truly interested in price stability, economic growth and economic freedom, it holds within its own hands the power to achieve all these goals and sustained high-level employment too.

Congress must realize that perfect stability in prices and employment is not attainable in a free, or indeed in any, economic system. If Congress has the wisdom to allow for a little play in the economy and develops the vision and courage to take its stand with economic growth the outlook will be bright. Riding on the outcome is our future as a free nation and the fate of the free world.

Very sincerely yours,

PADRAIC PEARSE FRUCHT.

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TREASURY DEPARTMENT,
*Washington, D.C., February 25, 1959.*

HON. WRIGHT PATMAN,
*House of Representatives,*
*Washington, D.C.*

MY DEAR MR. PATMAN: For Secretary Anderson, I am very glad to supply herewith answers to the additional questions which were enclosed in your letter addressed to the Secretary on February 20, 1959, concerning the proposed exchange of mortgages by FNMA for certain Treasury bonds.

Sincerely yours,

LAURENCE B. ROBBINS.

1. Q. In the answer to question 1, you show the distribution by type of holder of the currently outstanding \$5,550 million of 2¾ percent Treasury bonds, investment series B. As reported in the budget, only \$335 million of FNMA mortgages are to be offered in exchange. Since only a small fraction of the total 2¾ percent Treasury bonds, investment series B, will be accepted in exchange for the FNMA mortgages, wouldn't it be necessary to choose among the present bondholders those to be eligible for the exchange? Which of the present holders of the 2¾ percent Treasury bonds, investment series B, will be selected to engage in the proposed exchange? How will the selection be made?

A. As stated in Treasury's answer to previous question 1, only those companies or financial institutions qualified to invest in FHA-insured and VA-guaranteed mortgages and which are also holders of the 2¾ percent Treasury bonds, investment series B, would be eligible to acquire the mortgages to be sold or exchanged by FNMA. Many holders of the 2¾ percent Treasury bonds are not eligible to invest in the mortgages.

There would be a public notice of the proposed exchange and a specific notice would be mailed to each holder of the 2¾ percent bonds, as these bonds are issued only in registered form and the Treasury's registration records would be used as a mailing list for this purpose.

If FNMA should receive offers from holdersof more than \$335 million of the 2¾ percent bonds for the purchase or exchange of mortgages, the offers could be considered in the order they are received, or only the most advantageous offers could be accepted. On the other hand, there is no compelling reason to limit the sale or exchange to \$335 million. In this connection see the answer to question 5 below, in which it is pointed out that one of the purposes of the proposal is the liquidation of mortgages held by FNMA as contemplated by law.

FNMA in the course of its management and liquidating operations up to December 31, 1958, sold 130,000 VA-guaranteed mortgages amounting to $940 million, and held in this account at that date about 230,000 mortgages amounting to $1,350 million. The typical purchasers of FNMA's mortgages are usually interested in the mortgages on properties in certain localities, or in certain minimum principal amounts. Also, in many cases they acquire the mortgages from FNMA only after an inspection of the properties securing them. Other purchasers may be interested in acquiring mortgages which can be readily serviced by their existing servicing facilities. Because of the large mortgage holdings of FNMA, investors can find greater convenience of selection from seasoned holdings than by buying piece by piece from scattered sources. These are some of the many factors which bear upon the sale of mortgages by FNMA, in addition to the prices which purchasers offer for the mortgages.

2. Q. In the answer to question 4, you indicate some uncertainty about the manner in which the bondholders will record the FNMA mortgages acquired in the exchange. Yet you state that your best estimate is that the revenue loss will be insignificant. In order to make a revenue estimate, don't you have to make some assumptions about the class of bondholders whose bonds will be accepted in exchange for the FNMA mortgages and, moreover, some assumptions about the basis of the bonds in the hands of these holders and the basis of the FNMA mortgages in their hands? Since these respective bases will determine in large part the immediate tax consequences of the transaction, shouldn't the question of basis for the FNMA mortgages acquired be of considerable concern to the Treasury? Isn't the Treasury in a position to issue a ruling setting forth the basis to be used? If not, shouldn't the Treasury seek legislation to insure that no tax loss will result from the transaction?

A. If any uncertainty appears in the Treasury's answer to previous question 4 about the manner in which the bondholders will record for financial statement purposes the FNMA mortgages acquired in the exchange, this is due to the fact that a precise answer applicable to each purchaser cannot be given. (This should be distinguished from the treatment of such transaction for tax purposes.) The eligible purchasers of the mortgages, such as insurance companies, savings banks, pension and retirement funds, savings and loan associations, commercial banks, etc., are governed by Federal and State laws and regulations under which they are organized and operate, with respect to the manner in which they record and value their assets. Some purchasers may be allowed to record the mortgages they acquire at par value, and others may record them at market value at date of purchase.

In any event and no matter how the transactions are recorded on the purchasers' books, the purchase or exchange will constitute a taxable transaction under the Federal income tax laws. There will not be any special tax advantages to either party from the proposed transaction.

The management and liquidating function of FNMA is carried out as a governmental function and is not subject to tax or a charge in lieu of tax. As far as holders of Government bonds are concerned, the exchange of the bonds for the mortgages will be a taxable transaction (for those holders subject to tax), the gain or loss being a capital gain or loss in most cases. Due to the rise in interest rates in recent years, any exchanges can be expected to result in losses from a tax standpoint. The mortgages received in exchange will be valued for tax purposes at less than par and if paid off at maturity, or sold before maturity at more than the exchange value, will result in a gain to the holder, generally a capital gain.

These same results are taking place every day in ordinary market transactions. This is true even with respect to the 2¾ percent Treasury bonds mentioned in question 1 above. Although nonmarketable, the bonds can be exchanged for 1½ percent exchange notes. This is a nontaxable transaction with the notes taking the basis of the holder of the 2¾ percent bonds because it constitutes the transformation of the bonds pursuant to a right contained therein rather than a sale or exchange (Revenue Ruling 57-535). However, the 1½ percent notes are marketable and the seller who sells such notes then has a taxable transaction, which at the present prices will be a loss. In turn, the seller can use the proceeds from the notes to buy mortgages or bonds at a discount, or any other asset, with the intent of obtaining a capital gain.

The magnitude of the possible tax losses and future gains are set by the size of the proposed exchange and the present market price of the securities involved. If $335 million of mortgages are exchanged for equal amounts of Treasury

2¾-percent bonds, the maximum loss is about 10 percent or $33.5 million, with an approximate tax loss of $8.4 million (assuming a full 25-percent tax effect). Repayment of the mortgages at par will result in most cases in equal gains in later years. This also involves tax revenues of approximately $8.4 million on the same basis of 25 percent.

This assumes that all purchasers will be fully subject to Federal income taxes. This is not entirely the case, however, as mutual savings banks and savings and loan associations sometimes have no tax liability because of a statutory deduction permitted for additions to a reserve for bad debts. Pension funds generally are exempt from tax. In the case of commercial banks, any losses from the exchange of the bonds for mortgages would be fully reflected in reduced taxable income, as banks may treat the excess of losses from bonds as ordinary losses rather than capital losses. However, since commercial banks apparently hold only $130 million or about 2½ percent of the 2¾-percent Treasury bonds, their possible participation in the transaction will be relatively small.

It should be emphasized again, however, that the taking of the losses on the Government bonds is a common occurrence.

In view of the foregoing, there is no reason to issue any special ruling or to seek legislation.

3. Q. What is the volume of the VA guaranteed 4-percent mortgages now held by FNMA? What is the maturity schedule of these mortgages? Which of these would be offered in exchange for the 2½-percent Treasury bonds?

A. FNMA owned in its management and liquidating program as of December 31, 1958, an aggregate amount of $1,050 million of 4-percent VA-guaranteed mortgages. These are the principal class of mortgages it is proposed to sell or exchange for 2¾-precent Treasury bonds. These mortgages originally had terms of 20 to 30 years to maturity. They are amortized by monthly payments on account of principal and interest. Thus, based upon their original principal amounts and terms they had an average maturity of 26 years. They were acquired by FNMA during the period ending in 1954. FNMA's holdings of these mortgages are represented by 190,000 separate mortgages, the greater part of which are located in the following specified States (dollars in thousands):

| | *Amount* | | *Amount* |
|---|---|---|---|
| Alabama | $37,896 | Oklahoma | $81,538 |
| California | 246,412 | Tennessee | 28,830 |
| Florida | 82,086 | Texas | 150,631 |
| Georgia | 43,082 | Washington | 41,187 |
| Louisiana | 24,209 | | |
| Michigan | 148,836 | Total | 884,707 |

The average principal amount of the individual mortgages is about $5,600. Although the remaining terms of the mortgages necessarily vary, the bulk of final maturities will occur in a range having an average of about 16 years.

See also answer to question 1, above.

4. Q. The answers under questions 2, 3, and 4 suggest the possibility that the exchange will be treated by the present bondholders as a straight par value dollar-for-dollar exchange. In other words, for each par value dollar of 2¾ percent Treasury bonds, investment series B, given up, the present bondholders will get a par value dollar of 4 percent VA-insured mortgage. According to the answer, the VA-insured mortgages are seasoned and have a relatively early maturity, whereas the investment series bonds do not mature until 1980, callable in 1975, and while nonmarketable, are nevertheless exchangeable for 1½ percent 5-year Treasury marketable notes which are currently selling at a 9½ point discount. Isn't the net effect of the proposed exchange, therefore, to give the present bondholders higher yielding assets than they now hold without any real capital loss (perhaps even with a real capital gain), even though they may be able to claim a capital loss or an ordinary loss for tax purposes?

A. The answer to question 2 above explains fully the taxable status of the proposed sale or exchange of the FNMA 4 percent VA-guaranteed mortgages for 2¾ percent Treasury bonds.

Investors who are willing to exchange their 2¾ percent bonds for 4 percent mortgages will obtain an asset on which they will collect somewhat more interest than they now receive on the Treasury bonds. However, as pointed out in the answer to question 7 below, the 4-percent interest received on the mortgage will be reduced by the expenses and servicing costs incurred by the mortgage holder (this may amount to one-half of 1 percent or more). Many of the present bondholders who may make the exchange are subject to Federal income taxes. Any increase in interest earnings will be reflected in higher tax collections by the Treasury.

The difference between the average maturity term of the mortgages and the maturity of the 1½ percent notes (into which the 2¾ percent bonds are convertible) is a factor which influences the current market values of the two instruments. Inasmuch as the market values at the present time are approximately equal, holders of the bonds who exchange them for the mortgages will be able to substitute in their assets approximately the same par value of mortgages (an instrument partially guaranteed by the Veterans' Administration) for an equal par amount of 2¾ percent Treasury bonds (a direct public debt obligation of the United States). Because of this coincidence based upon present market prices, it is believed that some holders will be willing to exchange their bonds for mortgages, since both instruments are based in varying degree upon the credit of the United States.

Again, as pointed out in answer to question 2, this type of transaction takes place frequently in the market as investors sell Government or other bonds at a discount and buy other securities or mortgages for the purpose of realizing greater investment income.

5. Q. The answer to question 8 indicates that in fact the proposed exchange will leave the Treasury with the need for borrowing $335 million, just as if the level of mortgage purchases by FNMA proposed in the budget were to be financed without recourse to additional sales or exchanges by FNMA. Is this inference correct? If so, what useful purpose is served by the proposed exchange of FNMA assets for Treasury bonds of a lower yield?

A. The Treasury's answer to previous question 8 was directed to the specific inquiries raised in that question. It was pointed out that the exchange or sale of mortgages owned by FNMA for Treasury 2¾-percent bonds would not increase, reduce, or change the Treasury's need to borrow $335 million to be expended by FNMA for the purchase of mortgages in fiscal year 1960 under its special assistance program. However, a distinction was made between a transaction involving the sale or exchange of mortgages for Treasury 2¾-percent bonds and a transaction involving the sale of mortgages for cash.

The purpose to be served by the proposed exchange probably can be understood better if the operations of FNMA are briefly reviewed.

FNMA was reorganized under the FNMA Charter Act approved August 2, 1954. It was given three separate functions which are operated independently of each other, and for which FNMA must maintain separate accountability.

The first function involves the purchase of mortgages under its secondary market operations. The Treasury furnishes some capital for this operation, but the law contemplates that ultimately private capital will be substituted therefor. Funds for this activity are currently obtained principally by borrowing from the public. Expenditures under this program financed by borrowing from the public are not reflected in budget expenditures.

The second operation involves the purchase of mortgages under its special assistance functions. Funds for purchases of mortgages under this program are withdrawn from the Treasury and are reflected as budget expenditures. Collections and sales of mortgages under this program are also reflected as receipt items in the budget (credited against expenditures). Net budget expenditures for the special assistance program were $129 million in fiscal year 1958. They are estimated to amount to $867.8 million in fiscal year 1959 and $500 million in fiscal year 1960.

The third operation relates to mortgages held by FNMA when it was reorganized in 1954 which were required to be set aside under its management and liquidating functions. These mortgages had been acquired with funds borrowed from the Treasury, and when the mortgages were originally purchased by FNMA such purchases were reflected in budget expenditures. Collections from and the proceeds of sales of these mortgages have been reflected as receipt items in the budget (by credit against the expenditures). The Treasury is the residual recipient of all profits and losses from this operation. Net budget receipts (credited against expenditures) from the management and liquidating program amounted to $157.6 million in fiscal year 1958. They are estimated to amount to $190.2 million in fiscal year 1959 and $500 million in fiscal year 1960 (including the $335 million from the proposed sale of mortgages for 2¾ percent Treasury bonds).

The President included the following statement in his message to the Congress (p. M53) transmitting the budget for fiscal year 1960:

"For the fiscal year 1960, the Association will endeavor to cover its expenditures for mortgage purchases by receipts from mortgage sales and other sources. To make this possible without diverting the flow of new funds from the mortgage market, an estimated $335 million in Government-owned mortgages will be offered to investors in exchange for certain Government bonds which then will be retired."

The Congress made specific provison in the FNMA Charter Act, approved August 2, 1954, for the liquidation of mortgages owned by FNMA at that time. That act contains the following directive:

"The Congress hereby declares that the purposes of this title are to establish in the Federal Government a secondary market facility for home mortgages, to provide that the operations of such facility shall be financed by private capital to the maximum extent feasible, and to authorize such facility to—

"(a) * * *.

"(b) * * *.

"(c) Manage and liquidate the existing mortgage portfolio of the Federal National Mortgage Association in an orderly manner, with a minimum of adverse effect upon the home mortgage market and minimum loss to the Federal Government."

The proposed sale or exchange of $335 million of 4-percent, VA-guaranteed mortgages held in the management and liquidating program is a step in carrying out the congressional directive referred to above. In addition it will permit the maintenance of a balanced budget without requiring additional reductions in other expenditures or increases in taxes.

6. Q. The effect of the proposed exchange, as shown in the budget, is to reduce FNMA budget expenditures by $335 million. The answer to question 8 seems to state in effect that the proposed exchange does not affect the real volume or character of FNMA operations for the fiscal year. That is, the proposed net absorption or release of investable funds as a result of FNMA operations will not be affected by the proposed exchange. Is this inference correct, If so, doesn't it mean that the budget expenditure savings of $335 million is merely a bookkeeping savings?

A. The Treasury's answer to previous question 8 was not intended to lead to the inference that the proposed sale or exchange of $335 million of mortgages for 2¾-percent Treasury bonds does not affect the real volume or character of FNMA operations for fiscal year 1960.

As pointed out in the preceding answer to question 5, FNMA is conducting two operations having direct impact upon the Federal budget, namely, the special assistance program and the management and liquidation program. Net expenditures under these two programs, excluding the estimated receipts from the exchanges of mortgages for the 2¾-percent Treasury bonds, are estimated to amount to $335 million for fiscal year 1960. These estimated expenditures have been offset in the budget by estimated receipts of $335 million in the management and liquidating program from the sale of mortgages for 2¾-percent Treasury bonds. Unless these $335 million of receipts from the proposed sale of mortgages are realized, the estimated budget surplus of $70 million for fiscal year 1960 will be changed to an estimated deficit of $265 million. The sale or exchange of the mortgages for 2¾-percent Treasury bonds has the effect of applying these budget receipts to the reduction of an equivalent amount of the outstanding public debt. The public debt obligations will be received and retired. They will no longer represent an outstanding debt of the United States. Under these circumstances, it would seem clear that the proposal is not "merely a bookkeeping savings."

7. Q. The answer to question 8 also states that the proposed transaction, while not reducing the Treasury's cash needs, will have the effect of reducing the outstanding public debt, thereby furnishing the Treasury somewhat greater leeway under the present public debt limitation. Is this the major public purpose to be served by the proposed exchange? If so, isn't the price to be paid—the possible loss in tax revenues, the reallocation of interest paymnets to private holders and away from FNMA, and the very likely net increase in total interest payments—too high?

A. In the Treasury's answer to previous question 8, it was stated that the proposed transaction "would have the effect of reducing the outstanding public debt and thereby furnish a like margin under the public debt limitation which would be available for use by the Treasury" in financing its other needs. This statement was intended to refer only to one of the collateral advantages of the proposal, and was not intended as an indication of its major public purpose.

As indicated in the Treasury's answer to previous question 4, and as more fully explained in answer to question 2 above, the proposed transaction involves only an insignificant loss at most in tax revenues.

The net rate of interest collected by FNMA on the mortgages (after deducting its expenses and servicing costs) is somewhat more than the rate of interest paid by the Treasury on the 2¾-percent Treasury bonds. However, this represents the evaluation of investors in the public marketplace of the relative difference between investments in direct public debt obligations of the United States and investments in private mortgages guaranteed by the Veterans' Administration.

The Government should not actively compete with private industry by purchasing and holding interest-bearing mortgages and other evidences of indebtedness of private parties solely because it can make a profit over the lower rates of interest it pays when it borrows on public debt obligations.

## Congress of the United States Joint Economic Committee

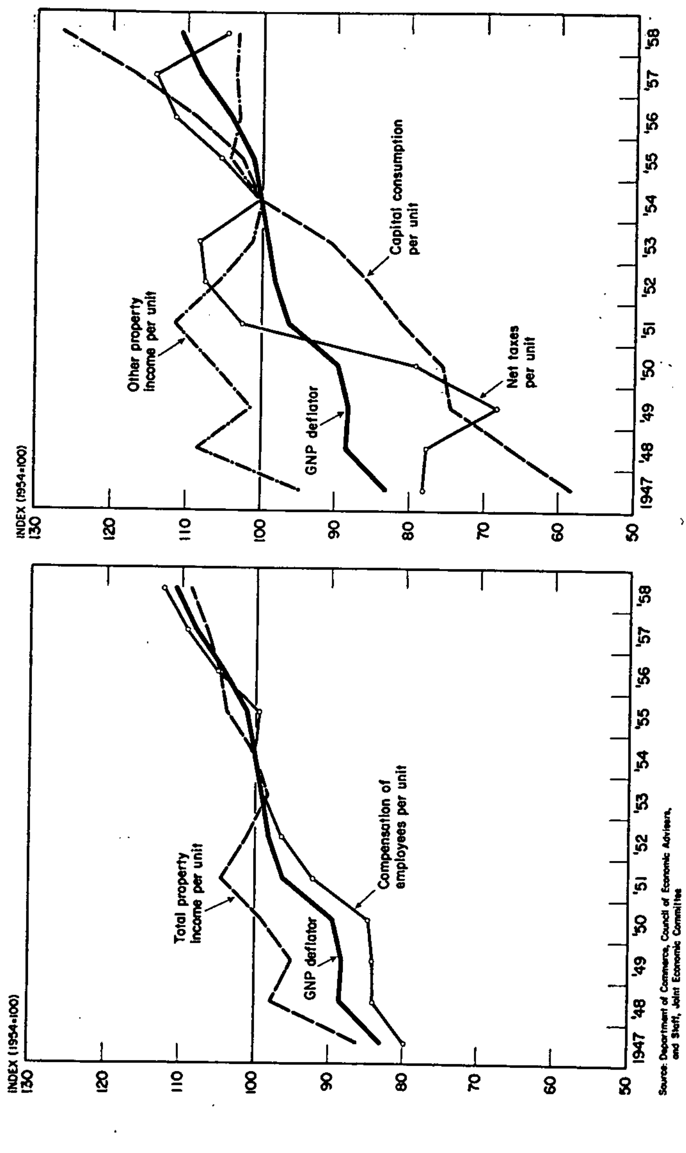
The following tables bring up to date the similarly numbered tables in the commitee print, "Productivity, Prices, and Incomes," materials prepared for the Joint Economic Committee by the committee staff, 85th Congress, 1st session (1957).

The first chart illustrates the data in table 48; the second chart illustrates selected items in table 50.

February 9, 1959.

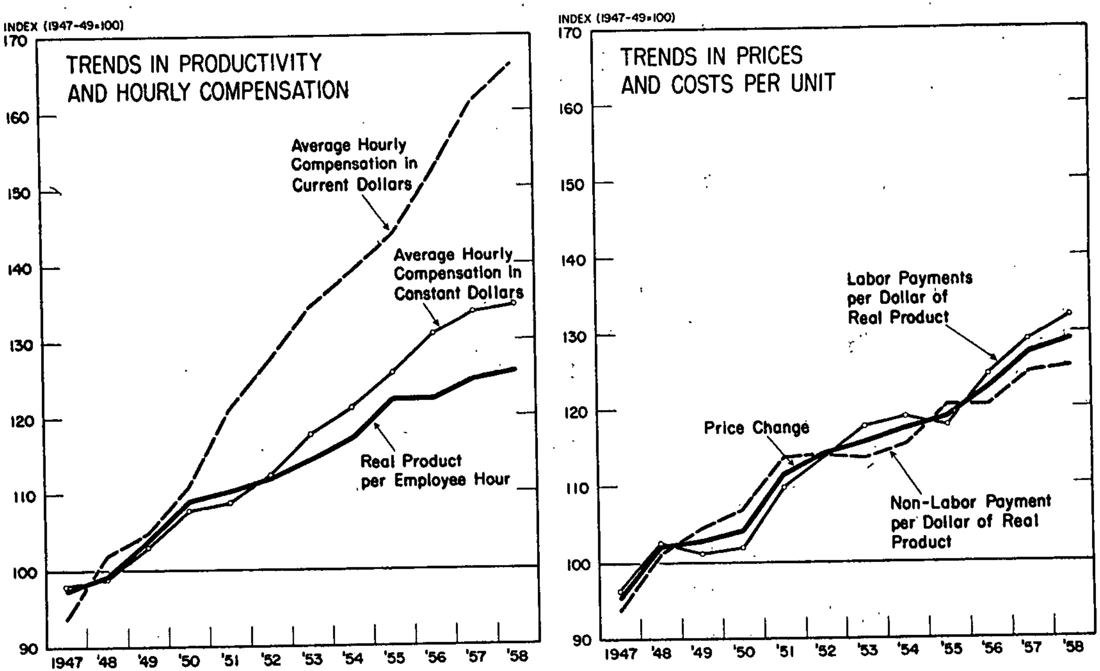
## PRICE COST RELATIONS AS ILLUSTRATED BY NATIONAL INCOME AND PRODUCT DATA

1947-1958




Source: Department of Commerce, Council of Economic Advisers, and Staff, Joint Economic Committee

# COSTS, PRICES, AND PRODUCTIVITY
## SELECTED DATA FOR THE PRIVATE NONAGRICULTURAL ECONOMY
### 1947-1958*




Source: U.S. Department of Commerce and U.S. Department of Labor, Bureau of Labor Statistics

*1958 PRELIMINARY

TABLE 3a.—*Indexes of real product per man-hour for the private economy, 1947–58, revised*

[1947–49=100]

| Year | Man-hour estimates based primarily on data from— | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Bureau of Labor Statistics | | | | | Bureau of the Census | | |
| | Total | Agriculture | Nonagricultural industries | | | Total | Agriculture | Nonagricultural industries |
| | | | Total | Manufacturing | Nonmanufacturing | | | |
| 1947 | 96.7 | 90.5 | 97.5 | 97.6 | 97.3 | 97.4 | 90.6 | 98.4 |
| 1948 | 100.2 | 107.1 | 99.4 | 100.1 | 98.9 | 100.3 | 107.5 | 99.4 |
| 1949 | 103.1 | 102.2 | 103.3 | 102.6 | 103.9 | 102.2 | 101.6 | 102.4 |
| 1950 | 110.4 | 116.2 | 108.8 | 109.5 | 108.4 | 110.3 | 116.1 | 108.5 |
| 1951 | 113.2 | 114.6 | 110.6 | 111.2 | 110.0 | 115.2 | 114.1 | 112.8 |
| 1952 | 115.7 | 124.5 | 112.0 | 113.0 | 111.3 | 118.9 | 124.0 | 115.5 |
| 1953 | 120.4 | 138.6 | 115.1 | 118.3 | 112.8 | 123.9 | 138.0 | 119.0 |
| 1954 | 122.6 | 148.3 | 116.9 | 117.4 | 116.7 | 127.0 | 147.9 | 121.8 |
| 1955 | 128.0 | 153.3 | 121.9 | 125.6 | 120.0 | 133.1 | 152.9 | 127.5 |
| 1956 | 128.8 | 160.7 | 121.8 | 127.1 | 119.1 | 134.2 | 160.2 | 127.7 |
| 1957 | 132.3 | 168.6 | 124.4 | 127.7 | 122.9 | 137.8 | 168.6 | 130.0 |
| 1958 [1] | 133.4 | 190.1 | 124.3 | (2) | (2) | 137.6 | 190.1 | 128.6 |

[1] Preliminary, subject to revision.
[2] Not available.

NOTE.—The indexes in this table were computed by Department of Labor, Bureau of Labor Statistics, from estimates of real product and man-hours. The real product estimates, referring to 1954 prices, are based primarily on national product statistics of the Department of Commerce, Office of Business Economics, except for the manufacturing real product estimates which were developed by the Bureau of Labor Statistics.

Output per man-hour estimates based primarily on Bureau of Labor Statistics man-hour data relate, in concept, to man-hours paid whereas estimates based primarily on Bureau of the Census labor force data relate, in concept, to hours worked. The difference between the 2 measures may, however, be due in part to statistical as well as conceptual differences. Both sets of man-hour estimates cover the man-hours of wage and salary workers, self-employed, and unpaid family workers.

Concepts, methods, and sources are described in forthcoming BLS report, "Postwar Trends in Outpu per Man-Hour, Total Private Economy and Major Sectors."

TABLE 11.—*Income originating in U.S. corporate business, by distributive shares, 1947–58*

| Year | Total income originating | Compensation of employees | Corporate profits and inventory valuation adjustment | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | Net interest | Total | Profits before tax | | Profits after tax | Inventory valuation adjustment |
| | | | | | Total | Profits tax liability | | |
| | Billions of dollars | | | | | | | |
| 1947 | 104.7 | 81.2 | 0.6 | 22.9 | 28.8 | 11.3 | 17.6 | −5.9 |
| 1948 | 120.4 | 90.0 | .3 | 30.0 | 32.2 | 12.5 | 19.7 | −2.2 |
| 1949 | 115.5 | 87.7 | .4 | 27.4 | 25.5 | 10.4 | 15.2 | 1.9 |
| 1950 | 132.3 | 97.4 | .2 | 34.7 | 39.6 | 17.9 | 21.8 | −5.0 |
| 1951 | 153.3 | 113.3 | .3 | 39.7 | 40.9 | 22.4 | 18.5 | −1.2 |
| 1952 | 158.5 | 121.6 | .3 | 36.6 | 35.6 | 19.5 | 16.1 | 1.0 |
| 1953 | 169.0 | 132.4 | .4 | 36.2 | 37.2 | 20.2 | 17.0 | −1.0 |
| 1954 | 163.3 | 130.4 | .5 | 32.3 | 32.6 | 17.2 | 15.4 | −.3 |
| 1955 | 184.2 | 142.2 | .5 | 41.6 | 43.3 | 21.8 | 21.5 | −1.7 |
| 1956 | 195.2 | 154.0 | (1) | 41.2 | 43.7 | 22.4 | 21.3 | −2.6 |
| 1957 | 202.1 | 161.9 | .2 | 40.0 | 41.5 | 21.6 | 19.9 | −1.5 |
| 1958 | 192.3 | 157.8 | .2 | 34.3 | 34.5 | 18.5 | 16.0 | −.2 |
| | Percentage distribution | | | | | | | |
| 1947 | 100.0 | 77.5 | 0.6 | 21.9 | 27.5 | 10.8 | 16.8 | −5.6 |
| 1948 | 100.0 | 74.8 | .3 | 24.9 | 26.7 | 10.4 | 16.3 | −1.8 |
| 1949 | 100.0 | 75.9 | .3 | 23.7 | 22.1 | 9.0 | 13.1 | 1.6 |
| 1950 | 100.0 | 73.6 | .2 | 26.2 | 30.0 | 13.5 | 16.4 | −3.8 |
| 1951 | 100.0 | 73.9 | .2 | 25.9 | 26.7 | 14.6 | 12.1 | −.8 |
| 1952 | 100.0 | 76.7 | .2 | 23.1 | 22.4 | 12.3 | 10.2 | .6 |
| 1953 | 100.0 | 78.4 | .2 | 21.4 | 22.0 | 12.0 | 10.0 | −.6 |
| 1954 | 100.0 | 79.9 | .3 | 19.8 | 20.0 | 10.5 | 9.5 | −.2 |
| 1955 | 100.0 | 77.2 | .2 | 22.6 | 23.5 | 11.8 | 11.7 | −.9 |
| 1956 | 100.0 | 78.9 | (1) | 21.1 | 22.4 | 11.5 | 10.9 | −1.3 |
| 1957 | 100.0 | 80.2 | .1 | 19.8 | 20.5 | 10.7 | 9.8 | −.8 |
| 1958 | 100.0 | 82.1 | .1 | 17.8 | 17.9 | 9.6 | 8.3 | −.1 |

1 Less than $50 million or 0.05 percent.

NOTE.—Detail may not add to totals because of rounding.

Source: 1947–57, U.S. Department of Commerce, Office of Business Economics; 1958, based on preliminary estimates by the Council of Economic Advisers.

TABLE 31.—*Income originating in manufacturing, by distributive shares, 1947–58*

| Year | Total national income (1) | Compensation of employees (2) | Corporate profits before tax: Total (3) | Corporate profits before tax: Corporate tax liability (4) | Corporate profits before tax: Corporate profits after tax (5) | Proprietors' income, net interest and inventory valuation adjustment (6) |
|---|---|---|---|---|---|---|
| | Millions of dollars | | | | | |
| 1947 | 58,717 | 44,537 | 16,529 | 6,474 | 10,055 | −2,349 |
| 1948 | 66,777 | 48,604 | 18,233 | 7,056 | 11,177 | −60 |
| 1949 | 62,702 | 46,124 | 14,203 | 5,713 | 8,490 | 2,375 |
| 1950 | 74,371 | 52,535 | 23,579 | 10,913 | 12,666 | −1,743 |
| 1951 | 88,495 | 62,418 | 24,999 | 14,364 | 10,635 | 1,078 |
| 1952 | 90,172 | 67,391 | 20,411 | 11,565 | 8,846 | 2,370 |
| 1953 | 97,953 | 74,809 | 22,116 | 12,395 | 9,721 | 1,028 |
| 1954 | 91,057 | 71,089 | 18,703 | 9,637 | 9,066 | 1,265 |
| 1955 | 104,490 | 77,979 | 26,310 | 13,109 | 13,201 | 201 |
| 1956 | 109,901 | 83,943 | 26,018 | 13,222 | 12,796 | −60 |
| 1957 | 112,517 | 87,671 | 24,467 | 12,321 | 12,146 | 379 |
| 1958 | 103,300 | 83,300 | 19,000 | 9,700 | 9,300 | 1,000 |
| | Percentage distribution | | | | | |
| 1947 | 100.0 | 75.9 | 28.2 | 11.0 | 17.1 | −4.0 |
| 1948 | 100.0 | 72.8 | 27.3 | 10.6 | 16.7 | −.1 |
| 1949 | 100.0 | 73.6 | 22.7 | 9.1 | 13.5 | 3.8 |
| 1950 | 100.0 | 70.6 | 31.7 | 14.7 | 17.0 | −2.3 |
| 1951 | 100.0 | 70.5 | 28.2 | 16.2 | 12.0 | 1.2 |
| 1952 | 100.0 | 74.7 | 22.6 | 12.8 | 9.8 | 2.6 |
| 1953 | 100.0 | 76.4 | 22.6 | 12.7 | 9.9 | 1.0 |
| 1954 | 100.0 | 78.1 | 20.5 | 10.6 | 10.0 | 1.4 |
| 1955 | 100.0 | 74.6 | 25.2 | 12.5 | 12.6 | .2 |
| 1956 | 100.0 | 76.4 | 23.7 | 12.0 | 11.6 | −.1 |
| 1957 | 100.0 | 77.9 | 21.7 | 11.0 | 10.8 | .3 |
| 1958 | 100.0 | 80.6 | 18.4 | 9.4 | 9.0 | 1.0 |

Source: 1947–57, U.S. Department of Commerce, Office of Business Economics; 1958, based on preliminary estimates by the Council of Economic Advisers.

TABLE 48.—*Price cost relations as illustrated by national income and product data, 1947–58*

[1954=100]

| Year | GNP deflator | Compensation of employees per unit | Property income or cost per unit | | | Other costs per unit | Net taxes per unit |
|---|---|---|---|---|---|---|---|
| | | | Total | Capital consumption allowances | All other | | |
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
| 1947 | 83.0 | 79.8 | 86.2 | 58.3 | 94.8 | 91.4 | 78.1 |
| 1948 | 88.5 | 84.1 | 98.7 | 66.6 | 108.5 | 78.0 | 77.7 |
| 1949 | 88.2 | 84.2 | 95.0 | 74.4 | 101.2 | 88.2 | 68.3 |
| 1950 | 89.5 | 84.8 | 99.1 | 75.5 | 106.3 | 83.1 | 79.2 |
| 1951 | 96.2 | 92.3 | 104.5 | 81.1 | 111.6 | 90.5 | 102.7 |
| 1952 | 98.1 | 96.5 | 101.2 | 85.6 | 105.9 | 97.4 | 107.6 |
| 1953 | 99.0 | 99.0 | 98.6 | 90.7 | 101.1 | 100.8 | 108.2 |
| 1954 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 1955 | 101.2 | 99.7 | 104.0 | 102.8 | 104.4 | 100.3 | 105.6 |
| 1956 | 104.2 | 105.2 | 104.4 | 108.7 | 103.1 | 97.8 | 111.7 |
| 1957 | 108.2 | 109.4 | 106.7 | 116.9 | 103.5 | 106.0 | 114.3 |
| 1958 | 110.7 | 112.6 | 108.9 | 126.6 | 103.4 | 106.3 | 104.7 |

Sources: All data for 1947-57 from the Office of Business Economics, U.S. Department of Commerce. Data for 1958 are preliminary estimates by the Council of Economic Advisers.

NOTES

Col. (1). The implicit price deflator for gross national product.
Col. (2). Computed by dividing total compensation of employees by GNP in constant 1954 dollars.
Col. (3). Combination of cols. (4) and (5).
Col. (4). Capital consumption allowances in current dollars divided by GNP in constant 1954 dollars.
Col. (5). Computed by subtracting compensation of employees from national income and dividing the result by GNP in 1954 dollars.

Col. (6). Computed by dividing all other costs included in GNP, but not accounted for directly in col. (2) through col. (5), by GNP in constant 1954 dollars. This consists of subsidies minus current surplus of Government enterprises, indirect business tax and nontax liability, business transfer payments, and statistical discrepancy.

Col. (7). Net taxes consists of total Government receipts (including Federal, State, and local governments) minus the following items, which represent transfers to the incomes of individuals, businesses, or foreigners: Subsidies minus current surplus of Government enterprises, net interest paid by Government, and Government transfer payments to persons and to abroad. Col. (7) is computed by dividing the resultant estimate of net taxes by GNP in constant 1954 dollars.

TABLE 50.—*Comparisons of indexes of labor and nonlabor payments, prices and output per man-hour, 1947–58*

[1947–49=100]

| Item | 1947 | 1948 | 1949 | 1950 | 1951 | 1952 | 1953 | 1954 | 1955 | 1956 | 1957 | 1958 [1] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Comparison of labor and nonlabor payments per dollar of real product and prices—private nonfarm sector: | | | | | | | | | | | | |
| 1. Employee compensation per dollar of real product | 96.1 | 102.6 | 101.2 | 101.9 | 109.7 | 114.1 | 117.5 | 118.8 | 117.9 | 124.4 | 129.0 | 132.2 |
| 2. Wages and salaries per dollar of real product | 96.1 | 102.8 | 101.0 | 100.9 | 108.1 | 112.7 | 116.1 | 116.9 | 115.7 | 122.0 | 125.9 | 128.9 |
| 3. Nonlabor payments per dollar of real product | 93.8 | 101.2 | 104.7 | 106.8 | 113.5 | 113.8 | 113.6 | 115.4 | 120.3 | 120.2 | 124.7 | 125.5 |
| 4. Implicit price change in nonfarm sector | 95.1 | 102.0 | 102.7 | 104.1 | 111.3 | 114.0 | 115.7 | 117.3 | 118.9 | 122.5 | 127.1 | 129.2 |
| Comparison of real product per man-hour for the total private economy and real hourly earnings: | | | | | | | | | | | | |
| 5. Real product per man-hour: Total private economy—all persons | 96.7 | 100.2 | 103.1 | 110.4 | 113.2 | 115.7 | 120.4 | 122.6 | 128.0 | 128.8 | 132.3 | 133.6 |
| Labor payments per employee man-hour in constant purchasing power: | | | | | | | | | | | | |
| Total private economy: | | | | | | | | | | | | |
| 6. Compensation per man-hour | 98.2 | 99.0 | 102.7 | 107.5 | 108.8 | 112.6 | 118.3 | 122.0 | 125.8 | 131.3 | 134.6 | 135.1 |
| 7. Wages and salaries per man-hour | 98.1 | 99.2 | 102.6 | 106.5 | 107.4 | 111.2 | 116.9 | 119.9 | 123.3 | 128.7 | 131.3 | 131.6 |
| Nonfarm economy: | | | | | | | | | | | | |
| 8. Compensation per man-hour | 97.9 | 99.0 | 103.0 | 107.8 | 108.8 | 112.3 | 117.6 | 121.1 | 125.7 | 130.9 | 134.0 | 134.7 |
| 9. Wages and salaries per man-hour | 97.9 | 99.2 | 102.8 | 106.7 | 107.3 | 110.9 | 116.1 | 119.1 | 123.3 | 128.2 | 130.8 | 131.4 |
| Underlying data: | | | | | | | | | | | | |
| Total private economy: | | | | | | | | | | | | |
| 10. Real product in constant dollars | 97.5 | 101.5 | 100.9 | 110.2 | 116.9 | 120.4 | 126.3 | 124.3 | 135.4 | 138.8 | 140.4 | 135.6 |
| 11. Compensation of employees in current dollars | 94.2 | 103.8 | 102.0 | 112.0 | 128.6 | 137.8 | 148.7 | 147.3 | 159.5 | 172.7 | 181.5 | 178.7 |
| 12. Wages and salaries of employees in current dollars | 94.1 | 104.0 | 101.9 | 111.0 | 126.9 | 136.0 | 146.9 | 144.9 | 156.5 | 169.2 | 177.0 | 174.1 |
| 13. Man-hours of all persons | 100.8 | 101.3 | 97.9 | 99.8 | 103.3 | 104.1 | 104.9 | 101.4 | 105.8 | 107.8 | 106.1 | 101.5 |
| 14. Man-hours of employees | 100.4 | 102.0 | 97.6 | 101.4 | 106.5 | 107.8 | 109.9 | 105.2 | 110.8 | 113.2 | 112.2 | 107.2 |
| Nonfarm sector: | | | | | | | | | | | | |
| 15. Real product in constant dollars | 97.9 | 101.2 | 101.0 | 110.5 | 118.1 | 121.6 | 127.7 | 125.2 | 136.7 | 140.3 | 142.3 | 136.7 |
| 16. Product in current dollars | 93.1 | 103.2 | 103.7 | 115.0 | 131.5 | 138.6 | 147.8 | 146.8 | 162.6 | 171.9 | 180.8 | 176.6 |
| 17. Compensation of employees in current dollars | 94.1 | 103.8 | 102.2 | 112.6 | 129.5 | 138.8 | 150.1 | 148.7 | 161.2 | 174.6 | 183.5 | 180.7 |
| 18. Wages and salaries of employees in current dollars | 94.1 | 104.0 | 102.0 | 111.5 | 127.7 | 137.1 | 148.2 | 146.3 | 158.2 | 171.1 | 179.1 | 176.2 |
| 19. Nonlabor payments in current dollars | 91.8 | 102.4 | 105.7 | 118.0 | 134.0 | 138.4 | 145.1 | 144.5 | 164.4 | 168.6 | 177.5 | 171.6 |
| 20. Man-hours of employees | 100.6 | 102.0 | 97.4 | 101.6 | 107.2 | 108.9 | 111.6 | 107.0 | 112.0 | 114.8 | 113.9 | 108.7 |
| 21. Average hourly compensation in current dollars | 93.5 | 101.8 | 104.9 | 110.8 | 120.8 | 127.5 | 134.5 | 139.0 | 143.9 | 152.1 | 161.1 | 166.2 |
| 22. Average hourly wages and salaries in current dollars | 93.5 | 102.0 | 104.7 | 109.7 | 119.1 | 125.9 | 132.8 | 136.7 | 141.2 | 149.0 | 157.2 | 162.1 |
| 23. Real product per employee man-hour | 97.3 | 99.2 | 103.7 | 108.8 | 110.2 | 111.7 | 114.4 | 117.0 | 122.1 | 122.2 | 124.9 | 125.8 |
| 24. "Consumer Price Index" | 95.5 | 102.8 | 101.8 | 102.8 | 111.0 | 113.5 | 114.4 | 114.8 | 114.5 | 116.2 | 120.2 | 123.4 |

[1] Preliminary.

Sources:
Line 1. Line 17 divided by line 15 or line 21 divided by line 23.
Line 2. Line 18 divided by line 15 or line 22 divided by line 23.
Line 3. Line 19 divided by line 15.
Line 4. Line 16 divided by line 15.
Line 5. Line 10 divided by line 13.
Line 6. Line 11 divided by line 14 and the resulting index divided by line 24.
Line 7. Line 12 divided by line 14 and the resulting index divided by line 24.
Line 8. Line 21 divided by line 24.
Line 9. Line 22 divided by line 24.

Line 10. Economic Report of the President, 1959, table D-4, p. 143. Gross private product in 1954 prices.

Line 11. U.S. Income and Output, a Supplement to the Survey of Current Business, 1959, table VI-1. Derived by subtracting compensation of general Government employees from total compensation. Includes employer's contribution to social security, private insurance and pension funds, compensation for injuries and a few other minor items of income in addition to wages and salaries. Compensation of employees of Government enterprises are included in the data. The 1958 figure is a BLS estimate based on OBE data.

Line 12. Same source as line 11, table VI-2. Wages and salaries include paid vacations, holidays, sick leave and other paid time off. Wages and salaries of employees of Government enterprises are included in the data. The 1958 figure is a BLS estimate based on OBE data.

Line 13. Estimated by the Bureau of Labor Statistics. Covers the hours worked or paid of persons in private industry—employees, proprietors and unpaid family workers in farm and nonfarm industries. Included also are the hours of employees of Government enterprises. The man-hour estimates are based on the BLS published series on employment and average weekly hours supplemented by national income and census labor force data.

Line 14. Estimated by the Bureau of Labor Statistics. Covers hours worked or paid of employees in private farm and nonfarm industries. Includes the man-hours of employees of Government enterprises, but excludes man-hours of proprietors and unpaid family workers.

Line 15. Derived by subtracting the farm product in 1954 prices published in the October 1958 "Survey of Current Business" from the gross private product in 1954 prices, line 10 above. The 1958 farm product estimate is based on the farm product in constant prices, "Economic Report of the President, 1959," table D-3, p. 142.

Line 16. "Economic Report of the President, 1959," table D-3, p. 142.

Line 17. Derived by subtracting the farm compensation from the total private compensation, line 11 above. Same source as line 11. The 1958 figure is a BLS estimate based on OBE data.

Line 18. Derived by subtracting farm wages and salaries from total private wages and salaries line 12 above. Same source as line 12. The 1958 figure is a BLS estimate based on OBE data.

Line 19. Derived by subtracting compensation of nonfarm employees, line 17, from the nonfarm private product, line 16. Includes corporate profits, capital consumption allowances, indirect business taxes, net interest, income of unincorporated enterprises, net rental income, and miscellaneous payments (including statistical discrepancy).

Line 20. Estimated by the Bureau of Labor Statistics. Covers man-hours worked or paid of all private nonfarm employees, including those employed by Government enterprises.

Line 21. Line 17 divided by line 20.
Line 22. Line 18 divided by line 20.
Line 23. Line 15 divided by line 20.
Line 24. "Economic Report of the President, 1959," table D-38, p. 184.

Source: Bureau of Labor Statistics.

TABLE 51.—*All manufacturing: Indexes of wholesale prices of finished goods, unit value added, total compensation of all employees, and production-worker payrolls per unit of output, 1952–58*

[1947–49=100]

| Year | Wholesale prices of finished goods (1) | Unit value added (2) | Total compensation of all employees per unit of output (3) | Production-worker payrolls per unit of output [1] (4) |
|---|---|---|---|---|
| 1952 | 111.5 | 115.8 | 116.2 | 109.3 |
| 1953 | 110.4 | 116.2 | 118.5 | 111.3 |
| 1954 | 110.7 | 117.2 | 120.6 | 108.4 |
| 1955 | 110.9 | 122.1 | 120.0 | 109.2 |
| 1956 | 114.0 | 125.3 | 125.6 | 112.1 |
| 1957 | 118.1 | 128.1 | 130.3 | 112.2 |
| 1958 [2] | 120.8 | 126.7 | 131.9 | 109.4 |

[1] Does not include wages and salaries of nonproduction workers. Production-worker payrolls include paid vacation, paid holidays, and sick leave and paid overtime but do not include other labor costs such as legally required payments by employers to old-age and survivors' insurance and unemployment compensation, employer contributions to health and insurance plans, supplementary unemployment benefits, and pension plans.

Payrolls per unit of output are determined by output per man-hour and average hourly earnings. The measure can be derived either as the ratio of total payrolls and production or payrolls per man-hour (average hourly earnings) and output per man-hour. If average hourly earnings are increasing, payrolls per unit will increase unless offset by proportionate increases in productivity. In interpreting estimates of payrolls per unit of output, it should be noted that the measures as usually constructed are affected by shifts between products with different levels of labor cost per unit.

Payrolls, and therefore payrolls per unit, include paid vacation, holidays, sick leave, and overtime. Where the ratio of payrolls per unit of output is derived by dividing payrolls per hour by output per hour a question is often raised as to whether hours worked or hours paid should be used in computing the ratios. The answer is that for this purpose either concept can be used as long as the same hour measure used in deriving the payrolls per hour ratio is also used in deriving the output per hour ratio. This is true because the hours estimates in both ratios, if they are consistent with each other, cancel out leaving payrolls devided by production.

Payrolls per unit do not show the proportion of total value which is distributed to labor nor what is happening to other costs. To analyze changes in total production costs it is necessary to have additional data on changes in material costs, profits, taxes, overhead costs, and prices, as well as fringe benefit labor costs such as employer payments to pension plans, to social security, and other non-wage-or-salary labor costs.

[2] Preliminary.

Source: Bureau of Labor Statistics. For details, see same numbered table in "Productivity, Prices, and Incomes."

TABLE 52.—*All manufacturing: Monthly indexes of production, production-worker payrolls, production-worker payrolls per unit of output, and prices of finished goods, July 1954–December 1958*

[1947–49=100]

| Period | Production | Payrolls | Production-worker payrolls per unit of output [1] | | Wholesale prices of finished goods |
|---|---|---|---|---|---|
| | | | Monthly | 12-month moving average | |
| | (1) | (2) | (3) | (4) | (5) |
| 1954—July | 116 | 131.9 | 113.7 | 108.7 | 111.1 |
| August | 125 | 134.8 | 107.8 | 108.3 | 111.1 |
| September | 127 | 138.0 | 108.7 | 108.1 | 110.6 |
| October | 132 | 139.1 | 105.4 | 107.8 | 110.2 |
| November | 132 | 142.2 | 107.7 | 107.7 | 110.6 |
| December | 129 | 143.1 | 110.9 | 107.6 | 110.2 |
| 1955—January | 133 | 141.4 | 106.3 | 107.6 | 110.6 |
| February | 136 | 144.3 | 106.1 | 107.8 | 110.8 |
| March | 140 | 146.5 | 104.6 | 107.9 | 110.2 |
| April | 140 | 146.7 | 104.8 | 108.1 | 110.6 |
| May | 140 | 150.1 | 107.2 | 108.3 | 110.2 |
| June | 141 | 152.1 | 107.9 | 108.6 | 110.6 |
| July | 132 | 151.0 | 114.4 | 108.9 | 110.5 |
| August | 140 | 154.6 | 110.4 | 109.2 | 110.9 |
| September | 144 | 158.6 | 110.1 | 109.5 | 111.5 |
| October | 150 | 161.2 | 107.5 | 109.8 | 111.3 |
| November | 148 | 164.0 | 110.8 | 110.1 | 111.6 |
| December | 143 | 164.0 | 114.7 | 110.4 | 111.5 |
| 1956—January | 144 | 159.3 | 110.6 | 110.6 | 111.8 |
| February | 146 | 158.1 | 108.3 | 110.8 | 112.0 |
| March | 145 | 158.2 | 109.1 | 111.0 | 112.3 |
| April | 146 | 158.5 | 108.6 | 111.3 | 112.7 |
| May | 142 | 156.4 | 110.1 | 111.5 | 113.6 |
| June | 142 | 158.5 | 111.6 | 111.7 | 114.0 |
| July | 129 | 151.3 | 117.3 | 111.9 | 114.0 |
| August | 143 | 161.6 | 113.0 | 112.1 | 114.1 |
| September | 148 | 166.8 | 112.7 | 112.3 | 115.3 |
| October | 153 | 169.1 | 110.5 | 112.4 | 115.6 |
| November | 149 | 168.1 | 112.8 | 112.6 | 116.2 |
| December | 146 | 171.2 | 117.3 | 112.7 | 116.2 |
| 1957—January | 146 | 165.3 | 113.2 | 112.7 | 116.7 |
| February | 149 | 164.9 | 110.7 | 112.7 | 117.0 |
| March | 149 | 164.2 | 110.2 | 112.6 | 116.9 |
| April | 146 | 162.1 | 111.0 | 112.5 | 117.4 |
| May | 144 | 160.9 | 111.7 | 112.4 | 117.4 |
| June | 146 | 163.7 | 112.1 | 112.3 | 117.6 |
| July | 137 | 160.9 | 117.4 | 111.2 | 118.5 |
| August | 147 | 164.6 | 112.0 | 112.1 | 118.6 |
| September | 148 | 164.7 | 111.3 | [2] 112.0 | 118.8 |
| October | 148 | 162.6 | 109.9 | [2] 111.9 | 119.0 |
| November | 144 | 160.7 | 111.6 | [2] 111.7 | 119.6 |
| December | 135 | 157.3 | 116.5 | [2] 111.4 | 119.9 |
| 1958—January | 134 | 149.9 | 111.9 | [2] 111.1 | 120.6 |
| February | 133 | 144.9 | 108.9 | [2] 110.9 | 120.6 |
| March | 131 | 143.6 | 109.6 | [2] 110.7 | [2] 121.4 |
| April [2] | 129 | 139.6 | 108.2 | 110.5 | 120.9 |
| May [2] | 129 | 140.9 | 109.2 | 110.1 | 121.0 |
| June [2] | 133 | 144.9 | 108.9 | 109.8 | 120.7 |
| July [2] | 127 | 144.8 | 114.0 | | 120.8 |
| August [2] | 138 | 150.0 | 108.7 | | 120.6 |
| September [2] | 141 | 155.7 | 110.4 | | 120.9 |
| October [2] | 145 | 152.5 | 105.2 | | 120.6 |
| November [2] | 146 | 158.1 | 108.3 | | 120.6 |
| December [2] | 142 | 160.1 | 112.7 | | 120.5 |

[1] See note 1, table 51.
[2] Preliminary.

Sources:
Col. (1). Federal Reserve index of industrial production for manufactures without seasonal adjustment.
Col. (2). Bureau of Labor Statistics production-worker payroll index in manufacturing.
Col. (3). Computed by dividing col. (2) by col. (1).
Col. (4). Computed from col. (3).
Col. (5). Bureau of Labor Statistics wholesale price index for finished goods.

TABLE 53.—*All manufacturing: Indexes of production, value added, compensation of employees, and production-worker payrolls, 1952–58*

[1947–49=100]

| Year | Production (1) | Value added (2) | Total compensation of employees (3) | Production worker payrolls (4) |
|---|---|---|---|---|
| 1952 | 125 | 144.8 | 145.2 | 136.6 |
| 1953 | 136 | 158.0 | 161.1 | 151.4 |
| 1954 | 127 | 148.9 | 153.1 | 137.7 |
| 1955 | 140 | 170.9 | 168.0 | 152.9 |
| 1956 | 144 | 180.4 | 180.8 | 161.4 |
| 1957 | 145 | 185.8 | 188.9 | 162.7 |
| 1958 [1] | 136 | 172.3 | 179.4 | 148.8 |

[1] Preliminary.

Sources:
Col. (1). Board of Governors of the Federal Reserve System.
Col. (2). Consists of national income originating in manufacturing plus depreciation changes incurred in manufacturing put on an index basis with 1947–49=100 from the Office of Business Economics, Department of Commerce.
Col. (3). Office of Business Economics, Department of Commerce; consists of wages and salaries of all employees plus other labor income.
Col. (4). Department of Labor, Bureau of Labor Statistics, Employment and Earnings.

TABLE 54.—*All manufacturing: Indexes of production, employment, productivity, payrolls, and production-worker payrolls per unit of output, 1954–58*

[1947–49=100]

| Year | Production (1) | Production workers (2) | Man-hours (3) | Output per man-hour (4) | Payrolls (5) | Production worker payrolls per unit of output [1] (6) |
|---|---|---|---|---|---|---|
| 1954 | 127.0 | 101.8 | 101.1 | 125.6 | 137.7 | 108.4 |
| 1955 | 140.0 | 105.6 | 107.7 | 130.0 | 152.9 | 109.2 |
| 1956 | 144.0 | 106.7 | 108.1 | 133.2 | 161.4 | 112.1 |
| 1957 | 145.0 | 104.4 | 104.1 | 139.3 | 162.7 | 112.2 |
| 1958 [2] | 136.0 | 94.2 | 92.6 | 146.9 | 148.8 | 109.4 |

[1] See note 1 to table 51.
[2] Preliminary figures for 1958.

Sources:
Col. (1). Federal Reserve Board.
Cols. (2), (3), (5). Department of Labor, Bureau of Labor Statistics.
Col. (4). Col. (1) divided by col. (3).
Col. (6) Col. (5) divided by col. (1).

TABLE 57.—*All manufacturing: Indexes of output per man-hour and real average hourly earnings, 1954–58*

[1947–49=100]

| Year | All manufacturing | | Ratio of real average hourly earnings to output per man-hour |
|---|---|---|---|
| | Output per man-hour | Real average hourly earnings | |
| | (1) | (2) | (3) |
| 1954 | 125.6 | 118.6 | 94.4 |
| 1955 | 130.0 | 124.0 | 95.4 |
| 1956 | 133.2 | 128.5 | 96.5 |
| 1957 | 139.3 | 130.0 | 93.3 |
| 1958 [1] | 146.9 | 130.2 | 88.6 |

[1] Preliminary figures for 1958.

Source:
Col. (1). Table 54, Col. (4).
Col. (2). Payrolls (table 54, col. 5) divided by man-hours (table 54, col. 3) adjusted to constant prices by dividing this result by the consumer price index. (See table 41, col. 1, "Productivity, prices and incomes.")
Col. (3). Col. (2) divided by col. (1).

The CHAIRMAN. I think copies of these statements have already been distributed to the press. They are available for any member who cares to look at them. Furthermore, I would remind the press that according to the basic legislation setting up this committee our report is due the first of March.

(Thereupon, at 12:35 p.m., the meeting was concluded.)

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