JANUARY 1960 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

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CONTENTS

PANEL DISCUSSIONS AND INDIVIDUAL WITNESSES IN ORDER OF APPEARANCE

Page

The economic outlook for 1960 — 1
Government fiscal position 1960–61—A translation of the January 1960 Federal budget into the national income and product accounts: Louis J. Paradiso, Assistant Director-Chief Statistician, Office of Business Economics — 1
Outlook for inventories, plant and equipment: Martin R. Gainsbrugh, Chief Economist, National Industrial Conference Board — 7
General outlook for 1960:
Dr. George Cline Smith, vice president and chief economist, F. W. Dodge Corp — 27
Peter Henle, assistant director of research, AFL–CIO — 37
Outlook for agriculture: George E. Brandow, Pennsylvania State University — 42
Outlook for the credit markets: Roy L. Reierson, vice president, and chief economist, Bankers Trust Co — 44
Council of Economic Advisers — 143
Raymond J. Saulnier, Chairman, Council of Economic Advisers, and Karl Brandt and Henry Wallich, members — 143
Monetary and credit policy for the coming year — 163
William McChesney Martin, Jr., Chairman, Board of Governors of the Federal Reserve System (accompanied by Ralph A. Young, secretary, Open Market Committee) — 163
Current fiscal and monetary policy recommendations — 217
Warren L. Smith, from the University of Michigan — 217
Richard A. Musgrave, the Johns Hopkins University — 237
Labor and management comments on the Economic Report — 259
Walter Reuther, president, UAW–AFL–CIO as presented by Stanley Ruttenberg, director of research — 259
Emerson P. Schmidt, Chamber of Commerce of the United States of America — 320
Ralph Robey, economic adviser, National Association of Manufacturers — 344
Additional comments by other group representatives — 354
W. E. Hamilton, Farm Bureau Federation — 354
Angus McDonald, National Farmers Union — 361
Herschel D. Newsom, master, the National Grange — 364
T. V. Houser, Chairman, Research and Policy Committee, Committee for Economic Development — 378
A. Arthur Charous, Trustee, Federal Statistics Users' Conference — 396
Policy recommendations — 403
Robert A. Gordon, University of California — 403
Paul Samuelson, Massachusetts — 406
William F. Butler of the Chase National Bank — 411
B. U. Ratchford, Duke University — 414
Fiscal policy of the coming year — 451
Robert B. Anderson, Secretary of the Treasury — 452

STATEMENTS AND EXHIBITS

Page

Anderson, Robert B., Secretary of the Treasury — 452
 Interest rates in selected countries — 469
 Yields on Government securities, May 29, 1959 — 459
Brandow, George E., Pennsylvania State University — 42
Butler, William F., the Chase Manhattan Bank — 411
 Postwar growth trend — 412
Charous, A. Arthur, trustee, Federal Statistics Users' Conference — 396
Gainsbrugh, Martin R., chief economist, National Industrial Conference Board — 7
 Research and development expenditures — 21–22
 The inventory-sales ratio for trade and manufacturing in three postwar expansions — 24
 Three cycles in business plant and equipment expenditures — 18
 Three cycles in manufacturing plant and equipment expenditures — 19
 Trade and manufacturing inventories in three postwar expansions — 25
Gordon, Robert A., University of California — 403
Hamilton, W. E., Farm Bureau Federation — 354
Henle, Peter, assistant director of research, AFL–CIO — 37
 Annual increase in total labor force, 1951–75 — 41
 Course of unemployment in three postwar recessions — 41
 Duration of unemployment — 42
Houser, T. V., chairman, Research and Policy Committee, Committee for Economic Development — 374
 Cash budget — 374
 Industrial production — 389
 Per capita disposable personal income in constant dollars — 393
 Prices (GNP price deflator) — 395
 Real gross national product — 390
 Real GNP in the private economy per man-hour worked — 394
 Real GNP per person employed or engaged in production — 392
 Straightening out economic growth — 388
 Total labor force — 391
Martin, Hon. William McChesney, Jr., Chairman, Board of Governors of the Federal Reserve System (accompanied by Ralph A. Young, Secretary, Open Market Committee) — 163
 Annual reports of Federal Reserve Board — 199
 Gross national product and demand deposits adjusted and currency — 177
McDonald, Angus, National Farmers Union — 361
Musgrave, Richard A., the Johns Hopkins University — 237
Newsom, Herschel D., master, the National Grange — 364
Paradiso, Louis J., Assistant Director-Chief Statistician, Office of Business Economics — 1
 Federal Government expenditures on national income accounts basis — 8
 Federal Government receipts and expenditures: Administrative budget, cash budget, and national income and product account, 1959–61 — 6
 Government purchases of goods and services — 9
 Receipts and expenditures of Federal, State, and local governments — 7
Ratchford, B. U., Duke University — 414
Reierson, Roy L., vice president and chief economist, Bankers Trust Co. — 44
 Bank credit and GNP — 78
 Bank credit and the money supply — 79
 Behavior of market yields — 81
 Credit expansion since World War II — 73
 Credit supplied by commercial banks and industrial activity — 76
 Credit supplied by others — 75
 Credit supplied by savings institutions — 75
 Expansion in credit — 72
 Expansion in long-term credit — 73
 Expansion in short-term credit — 74
 Foreign dollar balances — 89
 Gold movements versus Treasury bill rates — 88
 Gold reserves—U.S. versus rest of the world — 88
 Interest rates and prices — 85
 Interest rates and production during upturns — 84

Reierson, Roy L., Bankers Trust Co.—Continued Page
Loan ratios of commercial banks 77
Loans with Federal guarantees or insurance 86
Maturity of marketable Treasury debt 86
Money supply and liquid assets to GNP 80
Money supply and liquid assets to real GNP 80
Net borrowed reserves and interest rates 83
One-year marketable Treasury debt and Treasury bill yields 82
Sources of credit 74
Trends in prices and interest rates 85
Types of bank credit supplied 76
U.S. Government and agency debt held 87
Reuther, Walter, president, UAW-AFL-CIO, as presented by Stanley Ruttenberg, director of research 259
Economic growth rates following recessions 289
Changes in employment and unemployment, 1953-59 287
Increase in outstanding installment credit 266
Industrial production, employment and unemployment 265
Labor force, employment, and unemployment, 1953 and 1959 268
Long-term unemployment is rising 269
Manufacturing capacity and production, 1953-59 288
National production deficit 271
National production deficit—gross national product in 1959 dollars 285
Number of jobless—unemployment as percent of labor force 268
Operating rate as percent of capacity 270
Payroll costs of factory production and maintenance workers per unit of output—wholesale industrial prices 276
Six years of near stagnation, 1953-59—per capita total national production in 1959 dollars 286
Statement adopted by the AFL-CIO Economic Policy Committee, January 26, 1960 282
Unemployed as percent of labor force 286
Robey, Ralph, economic adviser, National Association of Manufacturers 344
Samuelson, Paul, Massachusetts Institute of Technology 406
Saulnier, Raymond J., Chairman, Council of Economic Advisers, and Karl Brandt and Henry Wallick, members 143
Schmidt, Emerson P., director of research, Chamber of Commerce of the United States of America 320
Letters to chairman 335, 338
Housing starts—with and without Government aid 324
Smith, Dr. George Cline, vice president and chief economist, F. W. Dodge Corp 27
Dodge Index, total construction contracts 36
Estimated dollar volume of construction contracts 35
Estimated physical volume of building contracts 35
Smith, Warren L., University of Michigan 217

ADDITIONAL INFORMATION

Article in Business Week, January 30, 1960 213
Article in U.S. News & World Report, August 31, 1959 306
Article in Washington Post, February 5, 1960 420
Correspondence between John W. Lehman, acting executive director of the committee and Maj. Gen. J. S. Bragdon, Special Assistant to the President for Public Works Planning 299
Earnings and earning ratios of all member banks 450
Personal savings as percentage of disposable personal income 304
Predictions for 1960 by the Federal Reserve Bank of Philadelphia, January 8, 1960 127
Questions submitted to Secretary of the Treasury, Robert B. Anderson, by Senator Douglas and replies thereto 489
Questions submitted to Secretary of the Treasury Robert B. Anderson by Hon. Wright Patman and replies thereto 491

JANUARY 1960 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, FEBRUARY 1, 1960

U.S. CONGRESS,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to call, at 10 a.m., in the Old Supreme Court Chamber, the Capitol, Hon. Paul H. Douglas (chairman of the committee) presiding.

Present: Senator Douglas; Representatives Patman, Reuss, Curtis, and Kilburn.

The CHAIRMAN. The committee will come to order.

The Economic Report of the President, submitted to the Congress on January 20, 1960, has been referred to this committee for study as provided in the Employment Act of 1946. Under the act the committee is to study the main recommendations of the report and, on or before March 1, advise the Congress of its views about them.

The CHAIRMAN. We are sorry to learn that the Secretary of the Treasury, Mr. Anderson, is unable to appear today, so this afternoon's session is canceled and his appearance postponed to a date to be announced later.

This morning we open the hearings with a panel of outstanding experts who will review the economic outlook for 1960. Each member of the panel has been asked to give particular attention to some aspect of the outlook, though all are free to summarize their judgments of economic prospects in general. I wish to stress that these gentlemen have been invited to appear as individuals, and as technicians, to give the committee the benefit of their expert advice, solely on the economic situation and outlook. They were assured in advance that they would not be asked to comment on policies or make policy recommendations.

We thank all of you gentlemen for your public spirit in coming to testify, and I am going to call first on Mr. Louis Paradiso, Office of Business Economics, to speak on the outlook for Federal, State, and local government expenditures; and we hope that it will be possible for the six of you to condense your presentation so that the total consumed will be an hour.

Mr. Paradiso.

STATEMENT OF LOUIS J. PARADISO, ASSISTANT DIRECTOR-CHIEF STATISTICIAN, OFFICE OF BUSINESS ECONOMICS

Mr. PARADISO. Mr. Chairman and members of the committee, I have prepared a statement in response to your request, translating the 1961 budget into the framework of the national income and product

accounts. This is for the purpose of assisting in your evaluation of the effects of Government operations on the economy, by placing Government demand in perspective. To conserve time, I shall summarize the highlights of this statement, which is submitted for the record. I shall be glad to endeavor to answer any questions which may be raised.

The major features of the budget translation follow with much of the material drawn from exhibits 1 and 2 of my statement:

1. Total Federal expenditures, on income and product account, in the fiscal year 1961 are estimated at $94 billion, up $1 billion from the indicated total for fiscal 1960 and $4 billion above the expenditures for the fiscal year just past, 1959. As you know, this is a more inclusive measure of expenditures than the $80 billion shown in the administration budget since the latter excludes trust fund expenditures. These data are shown in exhibit 1 of my statement.

2. That portion of expenditures representing Federal purchases of goods and services are scheduled for fiscal 1961 at $53½ billion, compared with $52½ in fiscal 1960. These Federal expenditures are shown in exhibit 2 and illustrated in exhibit 3. The ratio of Federal purchases to GNP was 11 percent in 1959 and on the basis of the asumption made in the President's message of a $510 billion GNP this calendar year would be 10 percent in 1960. Exhibit 4 shows these ratios for the postwar years.

3. National defense purchases are programed at about the same level in the next calendar year and a half. The estimate of $45½ billion in fiscal 1961 is about the same as the annual rate in the fourth calendar quarter of 1959.

4. Outlays for other categories than goods and services—such as transfer and interest payments and grants-in-aid—were $39 billion at an annual rate in the fourth quarter of calendar 1959. These are set forth as nearly $41 billion in fiscal 1961, an increase due mostly to higher payments under social security and other benefit programs and interest.

5. In the framework of the GNP accounts, the budget implies total receipts in fiscal 1961 of $101 billion, or $8 billion more than the budget estimate for fiscal 1960. This is larger than the $5½ billion increase shown by the administrative budget and results primarily from increases in trust fund receipts which are execluded in total from the administrative budget receipts and from the adjustment made to record corporate profits on an accural basis rather than collections.

The fiscal 1961 rise in receipts, as stated in the budget message of the President, is predicated on assumed gains in income and business activity this year. The Secretary of the Treasury in a press conference on the budget on January 16, 1960, indicated that for purposes of calculating revenues, the following assumptions were made:

(*a*) Personal income for calendar 1960 of $402 billion. This compares with the most recent record annual rate of $391 billion in December 1959.

(*b*) Corporate profits before taxes at $51 billion for calendar 1960, compared with an estimated $48 billion for calendar 1959.

The most recent estimate of the Office of Business Economics was $46½ billion annual rate in the third quarter of last year. We do not have as yet the estimate for the fourth quarter.

6. Comparing receipts with expenditures on a GNP accounts basis, there is an indicated surplus of $7 billion in fiscal 1961, compared with a balance between receipts and expenditures in fiscal 1960. The deficit in the fiscal year 1959 was $5½ billion. All of these are on the GNP accounts basis.

7. Data of the nature available from the Federal budget are lacking as you know, for the revenues and expenditures of State and local government agencies. For this we have utilized the information on the highway program, but for the remainder we have relied upon an extrapolation of recent trends which have been relatively stable. We are not in a position to make any calculations which would take into account special factors, such as interest rates and the availability of funds. Based on these considerations, purchases of goods and services by State and local government would total $49 billion in fiscal 1961, up $3 billion from fiscal 1960. The rise would be in the main increased compensation of employees.

Receipts by State and local governments—using the same basic economic assumptions as used in the Federal budget—would rise $3 billion in fiscal 1961 over fiscal 1960. These governments have run a deficit in recent years, and so we have assumed about the average of such deficits for the coming fiscal year or $1½ billion.

8. In summary, we would say that purchases of goods and services by all governments in this calendar year 1960 would be—granting the assumptions—$100 billion or $2 billion more than calendar year 1959. This would be nearly one-fifth of the assumed GNP. The total surplus for all governments combined would be approximately $5½ billion in fiscal 1961, compared with a total deficit of $1½ billion this fiscal year, and a deficit of $6½ billion in fiscal year 1959. Exhibit 2 summarizes these expenditures and receipts for all governments.

The CHAIRMAN. Thank you very much. Your prepared statement will be printed in full in the record.

(The prepared statement of Mr. Louis J. Paradiso is as follows:)

STATEMENT PREPARED BY LOUIS J. PARADISO, ASSISTANT DIRECTOR-CHIEF STATISTICIAN, OFFICE OF BUSINESS ECONOMICS, DEPARTMENT OF COMMERCE

GOVERNMENT FISCAL POSITION 1960–61—A TRANSLATION OF THE JANUARY 1960 FEDERAL BUDGET INTO THE NATIONAL INCOME AND PRODUCT ACCOUNTS

The budget submitted by the President last month indicated a substantial improvement in the Government's fiscal position. Federal receipts are estimated to be higher in fiscal 1961 by a substantially larger amount than the expenditures for that period. The improvement in receipts since fiscal 1959 is a reflection of the very considerable improvement which has already occurred in the economic situation, and of further gain this year.

A translation of the 1961 budget into the framework of the national income and product accounts helps to evaluate its effects upon the economy, and puts the Government demand in perspective with demands originating elsewhere in the economy. A statement for State and local governments is also required to complete the picture of all governmental activities.

Last year (calendar 1959) Federal purchases of goods and services amounted to $53½ billion, and accounted for a little more than 11 percent of the national output of goods and services—the gross national product. The national defense portion represented 9½ percent of the GNP—a little less than the 10 percent of 1957 and 1958. State and local governments purchased another 9 percent of the GNP. Thus, governments altogether absorbed more than one-fifth of our entire output of goods and services.

In addition to such purchases, governments, of course, influence the economy through other types of expenditures and by a variety of other activities and operations.

Federal expenditures

In considering the fiscal 1961 buget, I shall first turn to the expenditure aspect. Exhibit 1 shows Federal Government receipts and expenditures on an administrative budget, cash, and national income account basis. In the income framework, Federal expenditures in fiscal 1961 are set forth as $94 billion, up about $1 billion from the indicated total for fiscal 1960, and $4 billion above the actual expenditures for the fiscal year ended June 30, 1959. As you know, this is a more inclusive measure of expenditures than the $80 billion total shown in the administrative budget since the latter excludes trust fund expenditures.

All of the three measures of Government expenditures, those of the administrative and cash budgets, and that based on the national income and product accounts, show roughly the same increase in aggregate expenditures—about $1 billion—from fiscal 1960 to fiscal 1961. Exhibit 1 provides a reconciliation of the three budget measures by broad categories.

At this point I should like to indicate the major differences among the three measures of Government receipts and expenditures. The administrative budget does not include transactions of the trust funds which are included in both the cash budget and the national income and product account. The national income and product account measure differs from the other two in that corporate profits taxes are recorded on an accrual rather than a cash collections basis; loan transactions are either omitted or involve differences in timing; the acquisition of financial and second-hand assets are excluded; and an adjustment is incorporated for the lag between deliveries of and payments for goods.

The direct impact of expenditures on GNP is indicated by Federal purchases of goods and services. This is set forth in exhibit 2.

A year ago, as you will recall, the January budget indicated Federal expenditures for goods and services for each of the fiscal years 1959 and 1960 to be $54 billion. The actual for fiscal 1959 turned out to be very close to the estimate. The January budget of this year indicates a somewhat lower rate of purchases—$52½ billion for fiscal 1960. A rise to $53½ billion is programed for fiscal 1961. This compares with an annual rate in the fourth quarter of $53 billion.

For calendar 1960 the budget implies Government purchases at $52½ billion, fractionally below the actual for 1959. The GNP estimate underlying the figures given in the President's budget message for 1960 is substantially above that of 1959 and the ratio of Federal purchases to GNP for 1960 would therefore be lower—about 10 percent in contrast to 11 percent in 1959. As exhibit 4 shows, the ratio of Federal purchases to GNP reached a postwar high of 16 percent in 1953, when national defense expenditures were at the most recent peak which reflected the Korean hostilities. This total has since moved downward.

Total expenditures for categories other than goods and services—that is, transfer payments, grants-in-aid, net interest payments, and subsidies—were at an annual rate of nearly $39 billion in the fourth quarter of 1959. Using the budget as a basis, these would show little change in total during fiscal 1961. A small decline in Federal grants-in-aid to the States, is mostly associated with some reduction in Federal grants for highways. Both transfer payments and net interest paid by the Government are estimated to be higher.

The budget submitted for 1961, therefore, implies no pronounced changes from the current rate either in the purchases of goods and services or other types of expenditures. Loans and other capital transactions, for example, which declined sharply from fiscal 1959 to fiscal 1960 are expected to remain at the lower rate in fiscal 1961.

Federal receipts

The administrative budget receipts for fiscal 1961 are set forth at $84 billion, and this is based on the following assumptions:

(*a*) A gross national product for calendar 1960 of $510 billion, as set forth in the President's budget message in January. This total compares with about $480 billion estimated for calendar 1959, and an annual rate of about $482 billion in the fourth quarter of that year.

(*b*) A personal income total of $402 billion in calendar 1960, compared with $380 billion in calendar 1959. In December 1959—the latest month available—personal income had reached an annual rate of $391 billion.

(*c*) A corporate profits total of $51 billion in calendar 1960, compared with $48 billion in 1959.

Corporate profits before taxes reached a peak annual rate in the second quarter of last year, $52½ billion, a rate which probably reflected some anticipatory buying. In the third quarter, corporate profits dropped to $46½ billion due largely to the effects of the steel strike. This is the latest figure that the Office of Business Economics has calculated. Fourth quarter profits data for 1959 will not become available until after mid-April. In view of the mixed situation in the fourth quarter, it is more difficult than usual to calculate a figure at this time.

The personal income and corporate profits estimates given in (*b*) and (*c*) were issued in a statement by the Secretary of the Treasury at his budget press conference on January 16, 1960.

The budget implies receipts for fiscal 1961 of $101 billion on the national income accounts basis. This is $8 billion above the estimate for fiscal 1960. The administrative budget receipts in fiscal 1961 show a somewhat lesser rise, because the budget does not reflect an increase of nearly $2 billion in trust fund receipts and a rise of $1 billion in the excess of corporate tax accruals over tax collections.

The indicated surplus in the national income accounts framework is $7 billion in fiscal 1961 compared with expenditures about equal to receipts in fiscal 1960, and a deficit of $5½ billion in fiscal 1959.

In summary, the budget implies that Federal expenditures and purchases in the coming fiscal year will not differ substantially in aggregate from those in the current year, but revenues will rise sharply with further improvement in business.

State and local governments

Data of the nature available from the Federal budget are lacking for the revenues and expenditures of State and local government agencies. For this we have utilized the information on the highway program, but for the remainder we have relied upon an extrapolation of recent trends which have been relatively stable. We are not in a position to make any calculations which would take into account special factors, such as interest rates and the availability of funds. Based on these considerations, purchases of goods and services by State and local governments would total $49 billion in fiscal 1961, up $3 billion from fiscal 1960. The rise would be in the main increased compensation of employees.

Receipts by State and local governments—using the same basic economic assumptions as used in the Federal budget—would rise $3 billion in fiscal 1961 over fiscal 1960. These governments have run a deficit in recent years, and so we have assumed about the average of such deficits for the coming fiscal year or $1½ billion.

Rise in all government purchases

Combined demand for goods and services by Federal, State, and local governments are projected to rise in the coming fiscal year. For the fiscal year 1959, total Government purchases of goods and services were more than $96 billion; these are projected at close to $99 billion in fiscal 1960 and to $102½ billion in fiscal 1961. On a calendar-year basis, Government purchases of goods and services would rise from the total of $98 billion in 1959 to $100 billion in 1960. These data are summarized in exhibit 2.

For all governments combined, government receipts in fiscal 1961 would exceed expenditures by more than $5 billion. The indicated surplus of $7 billion in the national income accounts for the Federal Gocernment would be only partially offset by the calculated deficit of $1½ billion for State and local governments.

EXHIBIT 1

Federal Government receipts and expenditures—Administrative budget, cash budget, and national income and product account, 1959–61

[Billions of dollars]

	Fiscal years		
	1959 actual	Estimated	
		1960	1961
Receipts:			
Administrative budget	68.3	78.6	84.0
Plus trust fund receipts	17.1	20.7	22.5
Less intragovernmental transactions and other adjustments	3.7	4.5	4.4
Equals cash receipts from the public	81.7	94.8	102.2
Plus:			
Excess of tax accruals over tax collections, corporate	3.6	.2	1.0
Miscellaneous adjustments [1]	−.9	−2.0	−2.0
Equals national income and product account receipts	84.4	93.0	101.0
Expenditures:			
Administrative budget	80.7	78.4	79.8
Plus:			
Trust fund expenditures	18.6	21.5	21.3
Government-sponsored enterprise expenditures (net)	1.3	.6	−.3
Less intragovernmental transactions and other adjustments (including IMF notes)	5.8	5.2	4.5
Equals cash payments to the public	94.8	95.3	96.3
Less:			
Loans and other capital transactions	5.6	2.5	2.5
Miscellaneous adjustments [2]	−.7	−.3	−.1
Equals national income and product account expenditures	89.9	93.0	94.0
Surplus or deficit (−):			
Administrative budget	−12.4	.2	4.2
Cash budget	−13.1	−.5	5.9
National income and product account	−5.6	0	7.0

[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.

NOTE.—Detail will not necessarily add to totals because of rounding.

Source: Administrative and cash budgets from the Budget of the U.S. Government for the fiscal year ending June 30, 1961; national income and product account data from the U.S. Department of Commerce, Office of Business Economics, data for 1960 and 1961 based on estimates in the budget.

EXHIBIT 2

Receipts and expenditures of Federal, State, and local governments

[Billions of dollars]

	Calendar years		Fiscal years		
	1959 actual	1960 estimated [1]	1959 actual	Estimated	
				1960	1961
Federal:					
Receipts	89.0	97.0	84.4	93.0	101.0
Expenditures, total	91.0	94.0	89.9	93.0	94.0
Goods and services	53.6	52.5	53.8	52.5	53.5
State and local:					
Receipts	46.4	49.5	44.5	48.0	51.0
Expenditures, total	47.4	51.0	45.8	49.5	52.5
Goods and services	44.3	47.5	42.6	46.0	49.0
Total government:					
Receipts	128.8	140.0	123.0	134.5	145.5
Expenditures	131.9	138.5	129.5	136.0	140.0
Goods and services	97.9	100.0	96.4	98.5	102.5
Surplus or deficit (−)	−3.2	1.5	−6.5	−1.5	5.5

[1] These estimates are calendar year approximations derived from fiscal year data.

NOTE.—Federal grants-in-aid to State and local governments are reflected in Federal expenditures and State and local receipts and expenditures. Total Government receipts and expenditures have been adjusted th eliminate this duplication.

Source: U.S. Department of Commerce, Office of Business Economics. Data for the Federal Government for the years 1960 and 1961 based on estimates in the Budget of the U.S. Government for the fiscal year ending June 30, 1961. Data for State and local governments for the years 1960 and 1961 based primarily on the use of past trends.

The CHAIRMAN. The next paper is by our old friend, Martin Gainsbrugh, National Industrial Conference Board, on the outlook for inventories, plant, and equipment.

STATEMENT OF MARTIN R. GAINSBRUGH, CHIEF ECONOMIST, NATIONAL INDUSTRIAL CONFERENCE BOARD

Mr. GAINSBRUGH. I am delighted to be back, even though it meant taking a jet at 3 o'clock this morning from Los Angeles. The body is here; I hope the mind is.

From all available evidence, the outlook for capital goods spending is perhaps the most favorable of all the major economic sectors. In the latest recovery, capital outlays lagged on the upturn, just as they did earlier in the postwar period. Similarly, these expenditures should provide an upward thrust throughout 1960, and particularly in the second half, even as some other sectors lose momentum.

A key question in the outlook for 1960 is what will replace the stimulus of inventory replenishment as that fades in the months ahead. The answer that I would stress with each passing month of 1960 is the upsurge in private investment in new plant and equipment.

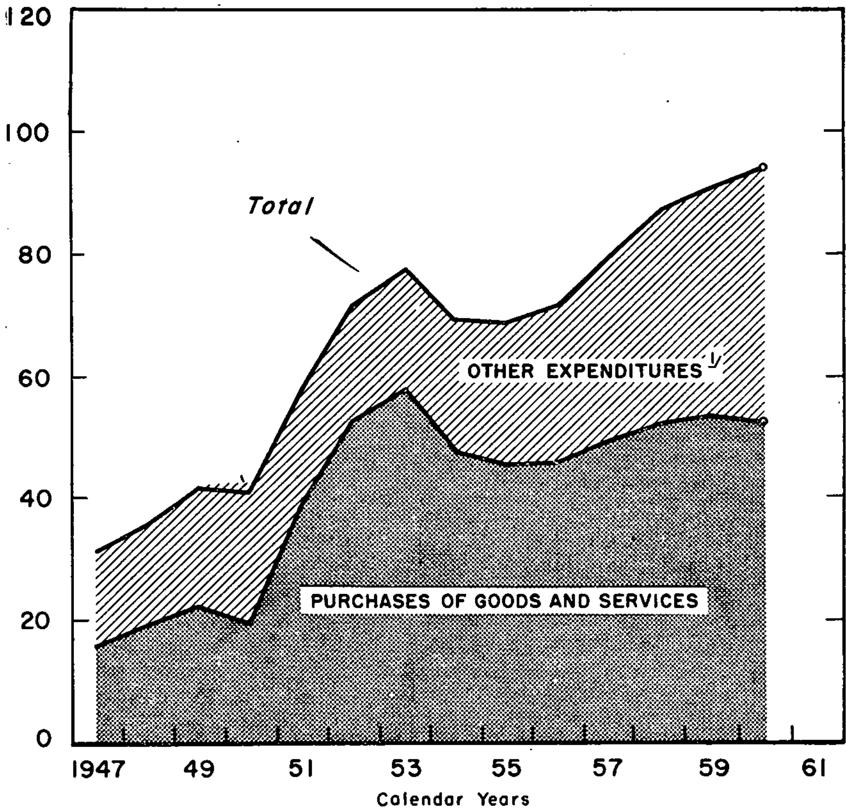
There are three surveys which make their contribution to the projection of capital spending. All of them support this conclusion.

I want to speak particularly of our survey of the investment plans of the thousand largest manufacturing corporations in this country. This survey is financed by Newsweek magazine.

In the third quarter of 1959, the thousand largest manufacturing corporations reported a 53 percent increase in capital appropriations

EXHIBIT 3

Federal Government Expenditures on National Income Accounts Basis

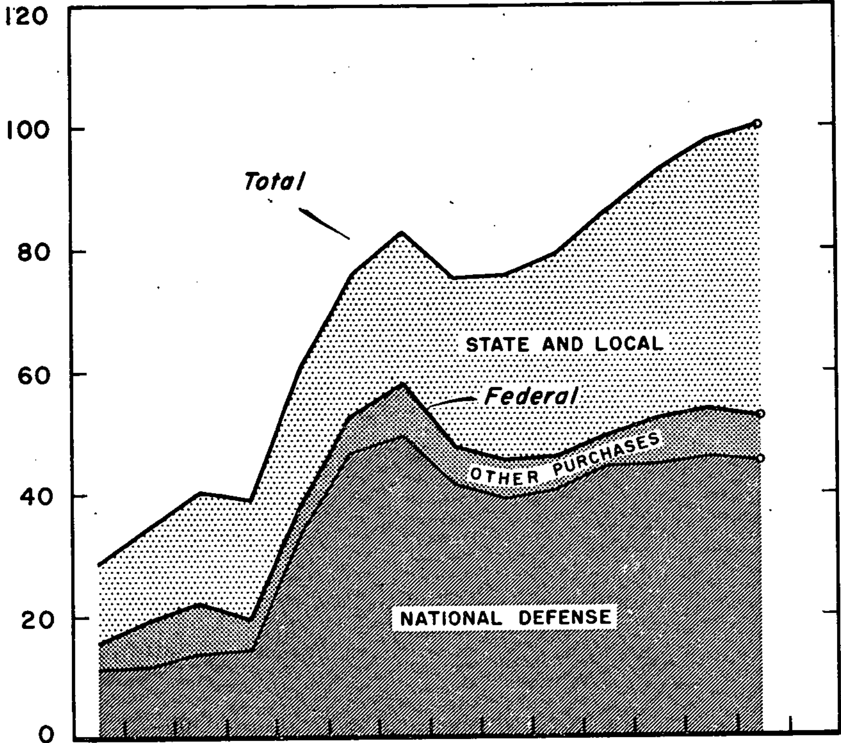


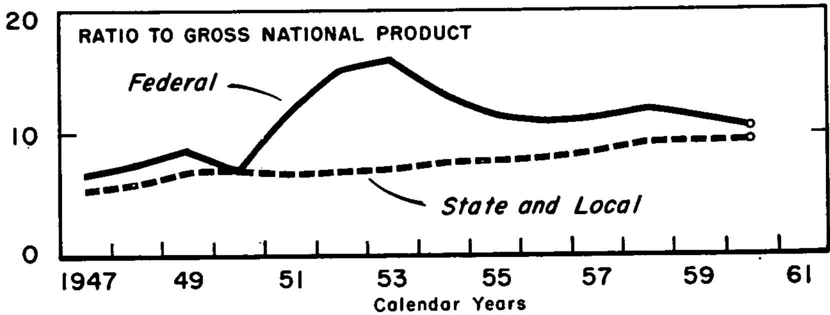
1/ *Includes transfer payments, grants-in-aid, net interest paid, and subsidies less current surplus of Government enterprises*

° *1960 based upon the President's January 1960 Budget*

EXHIBIT 4

Government Purchases of Goods and Services





° 1960 estimated by OBE, Federal purchases based upon the President's January 1960 Budget.

and their intentions to spend for plant and equipment over the year-ago rate. For the first 9 months of 1951, the rise in the capital appropriation approvals was 43 percent.

Now, what is significant about this increase in appropriations is that thus far the spending increase has only reflected the earlier modest appropriation gains of the second half of 1958. The 1959 upswing in approvals—and it is present again in the fourth quarter figures—has yet to be translated into spending. There is a 9-, 12-, to 15-month lag between the appropriations process and the spending process.

Still more substantial spending increases are on the way in the capital goods industries.

For this occasion, we had a preliminary run made of the fourth quarter capital appropriations. Some 113 returns have already come in. They suggest that despite the uncertainties of the steel strike and other unfavorable factors in the fourth quarter, the appropriations upswing was still continuing in the closing months of last year. This rise was particularly noteworthy in the iron and steel industry. Here the increase was substantial, perhaps doubling the rate of the fourth quarter of 1958. While these preliminary results are heavily weighted by this strong surge in steel, nevertheless, I should report that these early companies have an appropriation increase of 45 percent over the corresponding quarter a year earlier, which itself was the second quarter of the appropriation recovery. This represents a further increase, even after a rough adjustment for seasonal variation.

The continuing recovery of capital goods in this country is being paralleled in other countries as well. For example, the British Board of Trade has recently announced the results of their latest capital exepnditure survey which shows that private manufacturing industry now plans to spend in 1960 14 percent more than in 1959 in fixed assets. Total capital expenditure is now estimated to rise by 16 percent. This is in sharp contrast to the survey taken last summer which pointed to a 5 percent drop in 1960 capital spending in Great Britain.

Historical perspective suggests that a capital goods spending upswing has a considerable course to run before it turns into a decline. Thus, in the 1948–53 capital goods cycle, the expansion phase of business capital goods spending lasted 15 quarters. In the more recent 1953–57 cycle, the rise continued for 10 quarters. Thus far, in the current cycle, the expansion has proceeded for six quarters, including the current one. (See charts I and II.) If postwar history repeats itself, the present expansion in capital goods should continue at least four more quarters, extending into 1961.

However, there are reasons for believing that this may be an understatement of the extent of the potential rise in capital goods. Three factors should be considered in analyzing how far and how long capital goods spending will continue to expand. These are: First, the current and prospective flow of corporate profits and depreciation allowances; second, the past and current pace of technological change; and third, the relationship of current and potential output and capacity. After carefully considering these factors, it seems likely that the present expansion of capital goods spending may well continue beyond the 10 quarters of rise that took place in the 1953–57 cycle.

We offer in this connection on page 4 some information bearing on the current profit position of our industries.

The flow of profits and depreciation allowances is a vital factor in determining the level of capital spending, particularly in periods when the money market is tight and external financing of capital expenditures is difficult and expensive. The estimates of corporate profits underlying the President's latest budget message indicate a record $51 billion in calendar 1960. This would be $3 billion higher than in 1959, and a record dollar total to date. However, this dollar total should be placed in proper perspective. It would represent some 12 percent of national income, based upon the $510 billion gross national product for 1960, also cited in the President's budget, about the same relationship as in 1959 and 1957, both years of good business. By comparison, pretax corporate profits were 13.8 percent of national income in 1955 and 16.8 percent in 1950.

Together with rising depreciation allowances, this high level of profits should be sufficient for most capital needs of American business in 1960. Thus, 97 percent of the 228 manufacturing executives reporting in the latest conference board monthly survey of business opinion and experience said that their 1960 capital expenditure plans were not expected to be changed by the current scarcity of funds. Further, over nine-tenths of these executives expected their firms to finance 1960 capital spending wholly from internal sources.

Rising profits are closely connected with improved productivity, particularly in the recovery stage of the cycle when both rise in tandem. Previous expenditures on new plant and equipment and on research and development are now paying off. Even more expenditures for these purposes are likely to be encouraged when the previous expenditures pass the test of producing greater income. Thus, in addition to providing the funds required for capital expenditures, high profits encourage such expenditures, thereby playing a dual role in the capital spending decision.

A second factor relating to the volume of capital spending is technological change. The huge and rapidly growing research and development outlays of American industry—industry's research and development spending for 1959–60 was recently put at $9.4 billion by the National Science Foundation—create a swelling flow of new products and new processes which greatly stimulate spending for new plant and equipment. Thus most of the recent upsurge in capital appropriations seems centered in those industries most characterized by changing technology: Chemicals, rubber, textiles, electrical machinery.

The third but more troublesome point is the relation between output and capacity. By the end of 1957 there were significant areas of the economy characterized by excess capacity, a fact confirmed by the work at the conference board on capital-output ratios, as well as by the surveys conducted by McGraw-Hill and Fortune Magazine.

Recent trends in industrial production show an advance beyond the prerecession peak similar to the advance made by the end of 1955. Measuring from the trough, manufacturing production took 12 months to reach its previous peaks in 1954–55 and only 11 months in 1958–59. Even more encouraging is the fact that in 1958 the industrial output of consumer goods took only 7 months from the trough date to reach the previous peak, while in 1954–55 the same result took 11 months.

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Thus the recent recovery is if anything a little faster than the recovery of 1954–55.

But this relatively rapid comeback of industrial production need not imply that a burst of capital spendnig similar to that of 1955–57 will follow. In 1957 there was considerably more excess capacity than in 1953. Therefore, reaching the 1957 level of production still means a national output that is well below capacity. In the recovery of 1954–55 a much smaller advance was needed before there was pressure on capacity. Thus many months of production increases in 1960 may pass before there is comparable pressure on capacity. (The Federal Reserve's output index of metals and textiles was 86 percent of the comparable capacity index by June of last year. In 1955, an equal proportion of capacity was in use as early as February. At the previous output peak, in January 1956, this ratio was 94 percent. The extent of the current recovery is indicated by the 66 percent ratio of output to capacity in metals and textiles at the trough of April 1958.)

Comparisons of the course of the current recovery in capital appropriations and spending with the recovery of 1954–55 at first glance may seem to be at odds with the thesis that excess capacity is a negative factor in the capital goods recovery. The upward path of appropriations during the past five quarters has paralleled that of the 1954–55 recovery. In fact, the time patterns are quite similar, but the dollar total and the percentage gains are slightly below those of 1954–55. Trends in capital spending are slightly below those of 1954–55. Trends in capital spending also show the same relation between the current recovery and the last one.

On the surface, then, it would appear that like gains in industrial production are resulting in like gains in capital appropriations and spending. But this is actually far from the truth. For while dollar appropriations in 1959 were about the same level as in 1955, the value of the dollar has deteriorated considerably in the intervening 4 years, particularly when measured in terms of the plant and equipment that it can buy. The prices of plant and equipment have risen 10 to 15 percent in the past 4 years, and it seems highly unlikely that the quality of these goods can have improved so much in so short a time. Therefore, in real terms, the demand for capital goods is well below what it was 4 years ago, at a similar stage of the business cycle.

Considering the record levels of profits and depreciation allowances in 1959, the rise in appropriations and spending is modest indeed. Depreciation allowances are much higher than they were 4 years ago, and the difference in depreciation needs is even greater. Hence, while the real value of capital expenditures in 1959 and 1960 is lower than 4 years earlier, the real value of replacement needs is a good deal higher. Both these factors together imply that a much smaller portion of capital expenditures thus far has gone or is going into the expansion of productive capacities than went for these purposes in 1955–56.

Thus, despite a substantial growth in demand for final product, as evidenced in the rise in the industrial production index beyond the previous peak, the factor of excess capacity has greatly slowed the progress of the capital goods recovery. This recovery is at a lower level in real terms than the previous recovery. In comparison with our now larger economy, the current capital goods recovery seems

smaller still. Thus far, and in the immediate future as well, the emphasis of the capital goods recovery will be on cost cutting, modernization, and demand creation, rather than expansion of productive facilities.

My remarks to this committee 2 years ago, which were repeated last year, once again bear repeating:

> 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.

I repeated that same conclusion last year. This process of working off excess capacity has a twofold significance for the present upswing in business activity. In the first place, it implies that the upswing will not find as powerful a motive force in the capital-goods sector as it did in the last cycle. A second implication is that the upswing, though less rapid, may be of greater duration. This will be the case if the rise in demand and production is sustained long enough to work off most of the excess capacity. As capacity levels of output are approached in industry after industry, changes in the spending plans of those industries can be expected. They will shift from the slower growth which results from emphasis on modernization and replacement to the more rapid growth associated with expenditures aimed at expanding capacity. This additional boost to capital expenditures, coming at a relatively mature stage of the business upswing, might well prolong the prosperity phase.

For purposes of illustration, let us say that in most industries capacity levels are not approached until late in 1960. The resultant rise in capital spending might well provide sufficient impetus to propel the economy upward through 1961, and perhaps even into 1962—well beyond the turning point currently envisaged by most business analysts.

Such an eventuality would require, I repeat, a sustained rise in demand during most of 1960. Business, government, and consumers would all have to contribute to this rising demand. So far as business spending is concerned, it can be said with some measure of confidence that capital spending will continue to rise at least until late in 1960. Not only will 1960's total capital spending be greater than the total for 1959, but each quarter should show a higher total than the preceding quarter.

By late 1960 this sustained expansion could well exceed the previous peak in terms of current dollars; namely, $19.3 billion for plant and $29 billion for producers' durable equipment. (As for the equipment spending component, by the end of last year it had already approached within 5 percent of the previous peak.) In terms of its impact on incomes, and thus on expenditures in other sectors, the capital-goods upswing could be of major importance. In terms of pressure on capacity of the industries producing capital equipment, a peak current-dollar demand need not necessarily mean either a peak in real demand or an absorption of such excess capacity as exists in the capital-equipment industries. However, the greater emphasis of the current upswing on modernization than on expansion implies a greater emphasis on machinery than on construction. Thus, the machinery industries may find their output approaching capacity levels sooner than might be indicated by an analysis of total plant and equipment expenditures. In that case, they, too, would be stepping up their capital spending for expansion purposes.

Quantitative appraisals of inventory conditions in the last half of 1959 point uniformly to the conclusion that stocks were substantially below their normal relation to the volume of sales. On the basis of the historical behavior of inventories, a considerable addition to stocks in 1960 is a reasonable expectation.

By way of support for that conclusion, I would suggest that you examine chart III.

At mid-1959, the inventory-sales ratio in trade and manufacturing industries combined was 1.44; the ratio had declined almost without interruption in the preceding 14 months of recovery in general business conditions, and reached a level significantly lower than the lowest point reached following the recovery that began in August of 1954. By November 1959, the ratio had risen moderately, but the rise was primarily a reflection of reduced sales associated with the steel strike and its impact on deliveries in the automobile and other hard goods industries. Even at this artificially reduced sales level, the inventory-sales ratio in November 1959, was substantially lower than the ratio prevailing at a comparable point in time in the last two recoveries, and the ratio has doubtless subsided further since November as shipment rates have recovered.

Viewed in absolute terms (without regard to the associated volume of sales), the change in business inventories in the 19 months since the beginning of recovery in April 1958, has been almost negligible (chart IV). At comparable points in the past two recoveries, the book value of inventories had expanded by over 10 percent (following the 1954 trough) and about 35 percent (following the 1949 trough: in this instance, the period includes the start of the Korean war, and about half of the increase in book value of inventories reflected rising prices). Thirty-two months after the beginning of the two previous expansions (a period that corresponds in length to the period from April 1958, to the end of 1960), inventories had risen about 20 percent and about 38 percent. Viewed both in absolute terms and relative to sales volume, the level of inventories at the close of 1959 appears to have been substantially below normal, and substantially below the level they might be expected to reach in the course of a typical business cycle expansion.

A high degree of correlation exists between inventory-sales ratios for trade and manufacturing industries at a given point in time and the rate of change in inventories in the ensuing 6 months. Historically, the inventory-sales ratio prevailing in November 1959, is associated with an increase in the book value of inventories amounting to over 5 percent in the next 6 months. This would suggest an accumulation in the neighborhood of $5 billion between now and mid-1960, or an annual rate of accumulation of $10 billion. This figure is before inventory valuation adjustment; on the assumption that wholesale prices will rise at about 2 percent per annum during 1960, the inventory valuation adjustment would amount to about $2 billion, and the remaining $8 billion would appear as a positive change in trade and manufacturing inventories in the GNP account. This increase would normally be associated with an increase of over a half billion dollars in non-farm inventories other than trade and manufacturing: The total GNP figure for non-farm inventory change might thus approach $9 billion.

In addition to the influence of inventory-sales ratios, the behavior of inventories appears to be related to the relationship of new orders to sales. The inventory-sales ratio and the new orders-sales ratio prevailing in late 1959, taken together, have been associated with 6-month increases in inventories ranging from about 3 percent to 9 percent, and averaging a little less than 5 percent (chart IV). Treating both factors at the same time thus also suggests an expansion of the book value of inventory at about an $8 to $9 billion rate in the first half of 1960.

Mathematical forecasting of aggregate inventory behavior cannot be extended more than about 6 months into the future. For the last half of 1960, the prospective level of inventory may be viewed as a product of two assumptions covering the then prevailing sales rate, and the then prevailing inventory-sales ratio. On the conservative assumption that business sales in late 1960 will be approximately at the levels prevailing prior to the steel strike, and on the assumption that the inventory-sales ratio in late 1960 will approximate its level at the peaks of the last two business expansions, the implied increase in the book value of inventories for 1960 as a whole is roughly $9 billion. With the same sales assumption, but with the inventory-sales ratio assumed to be at approximately the level reached 32 months after the two previous business cycle troughs, the implied annual accumulation is about $11 billion. Assuming only a continuation into 1960 of the abnormally low sales rate prevailing in November 1959, a return to the range of inventory-sales ratios that has prevailed near the peak of the two preceding business cycles would yield an accumulation of about $5 billion.

In the durables manufacturing industries, where a substantial portion of total inventory fluctuation normally occurs, inventory levels are closely associated with sales volume in the preceding several months. Calculated inventory series, projected several months into the future on the basis of existing sales data, suggest that actual inventories are below their relationship to sales trends, and that rapid accumulation should be expected over the near term. This is true even if the actual—depressed—sales rates of the strike period are inserted into the equations; it is spectacularly true if the sales rates preceding the strike are used. These calculations, which are done by stage of fabrication, indicate that the shortage of inventories in these industries is concentrated in goods-in-process, where inventory changes are largely determined by objective rather than subjective considerations. Moderate accumulation is also indicated for purchased materials inventories and finished goods.

While virtually any quantitative approach to the trend of inventory demand in 1960 will point to the probability of a high rate of accumulation, opinions about inventory reported by specialists in inventory analysis and by businessmen themselves tend to stress moderation.

Louis Paradiso, who covered the subject of inventory conditions in the conference board's economic forum meeting on the business outlook for 1960, calculated a $10 billion requirement for additional inventories in 1960, but modified his forecast to $6 billion, partly on the basis of the dampening effects of high interest costs. In Mr. Paradiso's model, the $6 billion accumulation for the year as a whole would be

the result of an $8 billion rate of accumulation in the first half, and about a $4 billion rate in the second half.

The expectation that the rate of accumulation will fall in the second half is shared by many other published forecasts. A survey conducted by Dun's Review indicated that accumulation will be substantial in the first half and not as great in the second half, as steel stocks reach satisfactory levels. The findings suggested that inventory-sales ratios in manufacturing and in wholesale and retail trade will remain relatively low throughout the year as businessmen pursue a cautious inventory policy.

The business survey committee of the National Association of Purchasing Agents takes a similar view. The members of the association surveyed look for a relatively short buying rush of perhaps 3 or 4 months' duration, and a much more moderate rate of accumulation thereafter.

A survey of business intentions conducted by the National Industrial Conference Board found that tighter control over cash flow is being exercised by a significant proportion of companies participating in the survey, for the purpose of conserving cash under conditions of tight money and high borrowing costs. A frequently mentioned device for conserving cash was tighter inventory control.

Substantial additions to total business stock seem to be in prospect for all of 1960. The probabilities strongly favor an accumulation for the year as a whole in the neighborhood of $8 billion on a GNP basis; the rate in my judgment may be only moderately higher in the first half of the year than in the second half. I see nothing fatalistic developing in the way of a tremendous buildup of inventories in the first half of 1960 that would turn the economy down in the closing half of 1960.

It should be added that as with other demands entering into total national expenditures, the course of inventory demand is not independent of the behavior of the other sectors of the economy. If demands for plant and equipment and automobiles justify the generally favorable expectations now held for these markets, it seems altogether unlikely that accumulation will bring inventories to an excessive level by midyear and inventory demand is hardly likely to reverse at any point in the second half. Phrasing the inventory outlook this way is useful because it stresses the dominant role of end-product demands in the year ahead. If these demands are as strong as they now appear to be, even substantial inventory accumulation in 1960 need not be excessive, speculative, or dangerous; it will simply be a necessary concomitant of higher operating rates and sales volume.

The CHAIRMAN. Thank you very much. Your entire statement will appear in the record.

(The prepared statement of Martin R. Gainsbrugh is as follows:)

OUTLOOK FOR INVENTORIES, PLANT, AND EQUIPMENT

STATEMENT BY MARTIN R. GAINSBRUGH, CHIEF ECONOMIST, NATIONAL INDUSTRIAL CONFERENCE BOARD

THE OUTLOOK FOR CAPITAL GOODS DEMAND IN 1960

(NOTE.—The author wishes to express his appreciation for the contributions of Morris Cohen in the preparation of the materials on plant and equipment and Albert T. Sommers for the section on inventories.)

From all available evidence, the outlook for capital goods spending is perhaps the most favorable of all the major economic sectors. In the latest recovery, capital outlays lagged on the upturn, just as they did earlier in the postwar period. Similarly, these expenditures should provide an upward thrust throughout 1960, and particularly in the second half, even as some other sectors lose momentum.

All three surveys—Commerce-SEC, McGraw-Hill, and the conference board capital appropriations—which make their contribution to the projection of capital spending point in this direction.[1] The conference board survey, conducted under the sponsorship of Newsweek magazine, points to an increase in 1960 capital spending by the important manufacturing sector greater than the other two series. In the third quarter, manufacturing concerns reported a substantial 53-percent boost in capital appropriations over the year-ago rate. For the first 9 months of 1959, the rise in capital appropriaiton approvals was 43 percent. Thus far, at least in most of 1959, the spending increase has reflected primarily the previous and more modest appropriation gains of the second half of 1958. The 1959 upswing in approvals has yet to be fully translated into spending. Still more substantial spending increases are on the way.

While it is still too early to make any definitive statements about fourth-quarter capital appropriation survey results, the first 113 returns that have come in suggest that the appropriations upswing continued into the closing months of last year. Particularly noteworthy were the first returns from the iron and steel industry which resumed production after the record-long strike. Here the increase was substantial, perhaps doubling the rate of the fourth quarter of 1958. While these preliminary results are heavily weighted by this strong surge in steel, nevertheless, I should report that these early companies have an appropriation increase of 45 percent over the corresponding quarter a year earlier, which itself was the second quarter of the appropriation recovery, and this represents a further increase even after a rough adjustment for seasonal variation.

The continuing recovery of capital goods in this country is being paralleled in other countries as well. For example, the British Board of Trade has recently announced the results of their latest capital expenditure survey which shows that private manufacturing industry now plans to spend in 1960 14 percent more than in 1959 on fixed assets. Total capital expenditure is now estimated to rise by 16 percent. This is in sharp contrast to the survey taken last summer which pointed to a 5-percent drop in 1960 capital spending in Great Britain.

Historical perspective

Historical perspective suggests that a capital goods spending upswing has a considerable course to run before it turns into a decline. Thus, in the 1948–53 capital goods cycle, the expansion phase of business capital goods spending lasted 15 quarters. In the more recent 1953–57 cycle, the rise continued for 10 quarters. Thus far, in the current cycle, the expansion has proceeded for six quarters, including the current one. (See charts I and II.) If postwar history repeats itself, the present expansion in capital goods should continue at least four more quarters, extending into 1961.

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[1] The McGraw-Hill survey of last November reported a 10-percent rise in all business capital spending in 1960 compared to 1959, with the 19-percent rise reported by the manufacturing sector in the lead. The December plant and equipment survey report by the Department of Commerce and the Securities and Exchange Commission already showed that the first quarter of this year was running at 5 percent over the 1959 average, with manufacturing up 15 percent. The latest Commerce-SEC survey indicated the extent to which the lack of steel deliveries in the second half of last year affected capital outlays. From the September to the December Commerce-SEC reports, fourth-quarter 1959 spending on plant and equipment had been lowered by about $1.5 billion, annual rate.

CHART 1

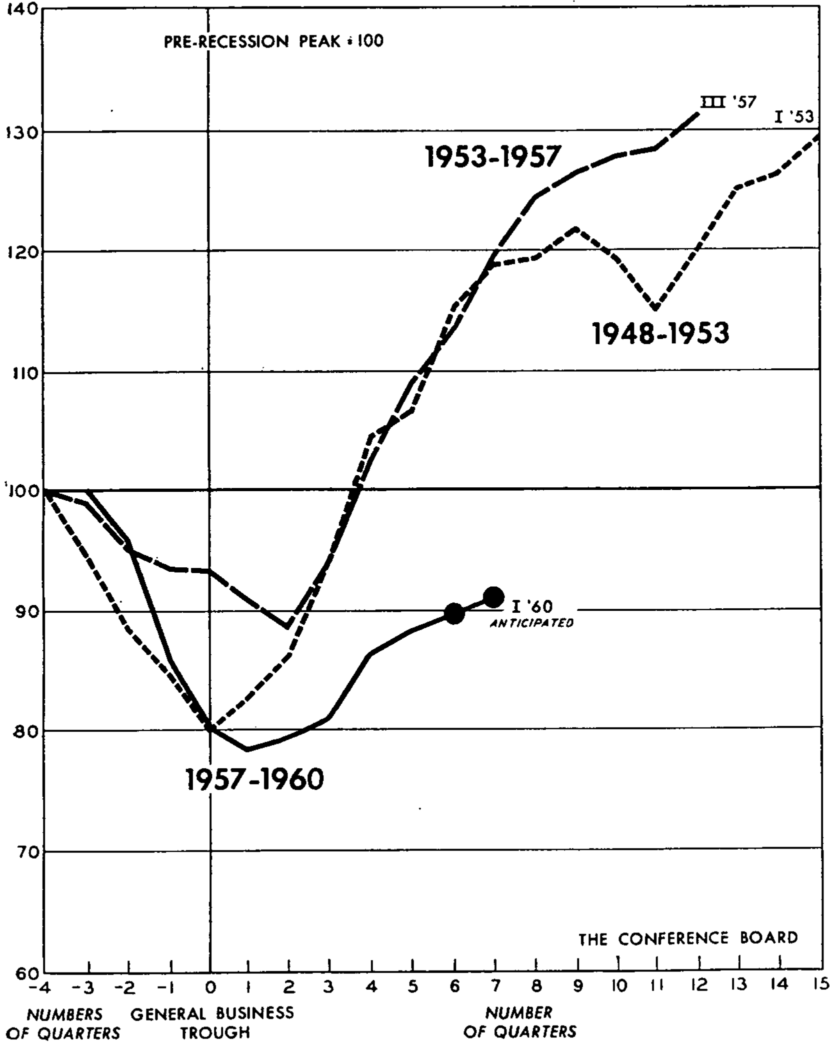
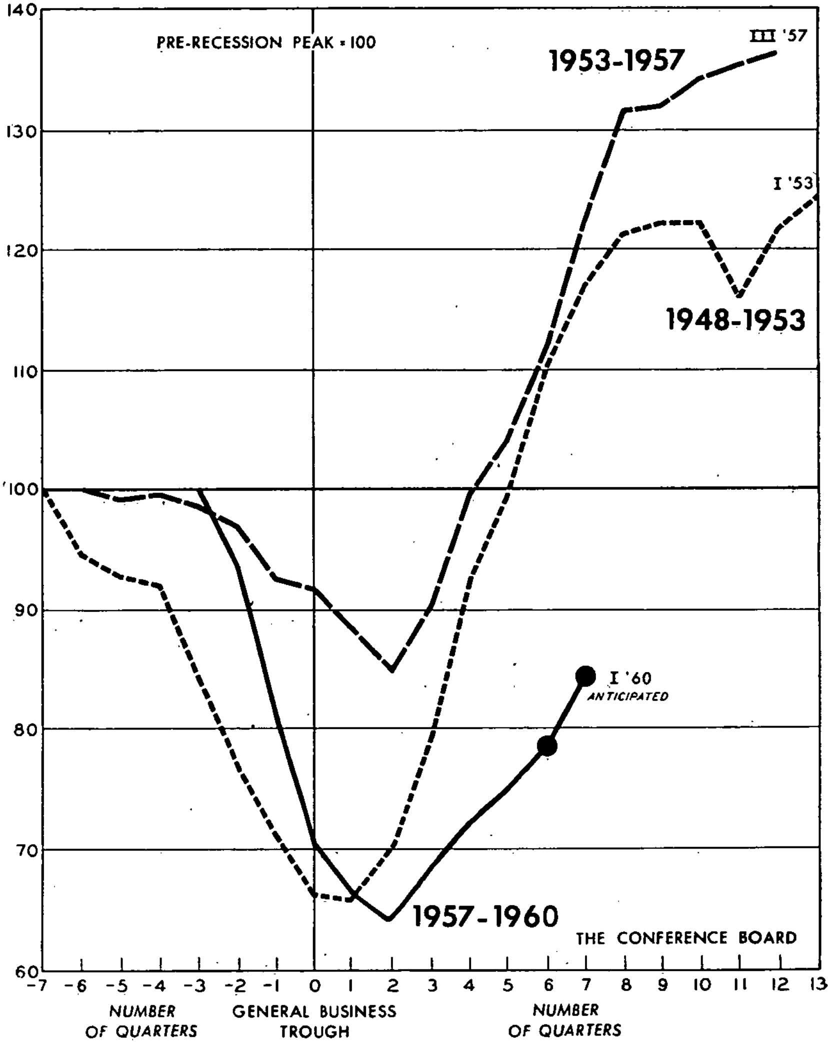


CHART 2



However, there are reasons for believing that this may be an understatement of the extent of the potential rise in capital goods. Three factors should be considered in analyzing how far and how long capital goods spending will continue to expand. These are, first, the current and prospective flow of corporate profits and depreciation allowances; second, the past and current pace of technological change; and third, the relationship of current and potential output and capacity. After carefully considering these factors, it seems likely that the present expansion of capital goods spending may well continue beyond the 10 quarters of rise that took place in the 1953–57 cycle.

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Output and capacity

The third but more troublesome point is the relation between output and capacity. By the end of 1957 there were significant areas of the economy characterized by excess capacity, a fact confirmed by the work at the conference board on capital-output ratios, as well as by the surveys conducted by McGraw-Hill and Fortune magazine.

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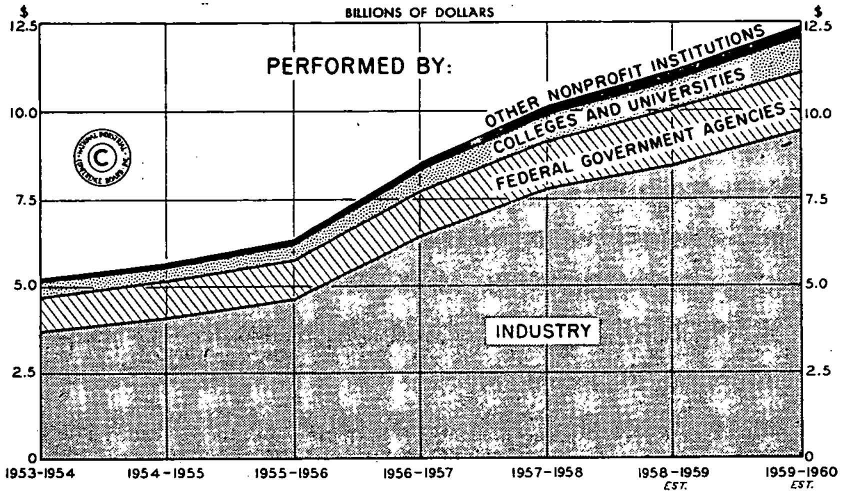
RESEARCH & DEVELOPMENT



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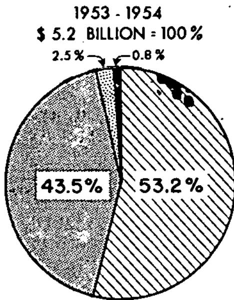

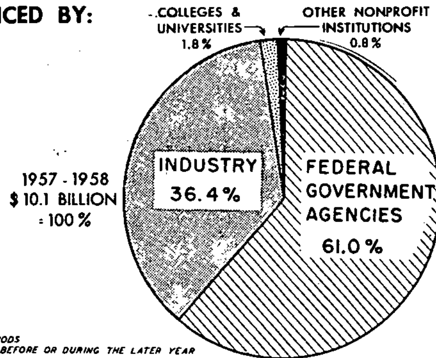

NOTE: THE HYPHENATED YEARS REPRESENT 12-MONTH PERIODS BEGINNING IN THE EARLIER YEAR AND ENDING JUST BEFORE OR DURING THE LATER YEAR

SEE REVERSE FOR ADDITIONAL DATA

Expenditures for research and development will reach an estimated $12.4 billion in the 1959-1960 period, more than double the nearly $5.2 billion spent in 1953-1954. Industry currently accounts for three fourths of all funds spent, the Federal Government agencies accounting for only one seventh. But the Federal Government continues to be the main supplier of research and development funds.

Source: National Science Foundation

Research and development expenditures

[Millions of dollars]

	1953-54	1954-55	1955-56	1956-57	1957-58	1958-59 (estimate)	1959-60 (estimate)
Federal Government agencies	970	950	1,090	1,280	1,450	1,720	1,780
Industry	3,630	4,070	4,640	6,440	7,730	8,400	9,400
Colleges and universities	450	480	530	600	720	840	1,000
Other nonprofit institutions	100	120	130	140	150	200	250
Total	5,150	5,620	6,390	8,460	10,050	11,160	12,430

DEFINITIONS

Research and development: "The systematic and intensive study directed toward a fuller knowledge of the subject studied and use of that knowledge directed toward the production of useful materials, devices, systems, methods, or processes." The concept includes all operating costs, direct and indirect, including the planning and administration of such research. Research and development performed by industry under Federal production and procurement contracts is also included. In general, capital items are excluded, as are routine testing, mapping and surveys, collection of general-purpose statistics, experimental production, and activities concerned primarily with dissemination of scientific information or the training of scientific manpower.

Industry: Includes private firms in manufacturing and nonmanufacturing industries, independent commercial laboratories, engineering service firms, trade associations, and Federal contract research centers administered by industrial organizations.

Colleges and universities: Include institutions of higher education and their associated research centers, agricultural experiment stations, graduate and professional schools, affiliated hospitals, and Federal contract research centers administered by educational institutions.

Other nonprofit institutions: Include private philanthropic foundations, nonprofit research institutes, voluntary health agencies, academies of science, professional societies, museums, zoological gardens, botanical gardens, arboretums, and Federal research centers administered by independent organizations.

Source: National Science Foundation.

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For purposes of illustration, let us say that in most industries capacity levels are not approached until late in 1960. The resultant rise in capital spending might well provide sufficient impetus to propel the economy upward through 1961 and perhaps even into 1962—well beyond the turning point currently envisaged by most business analysts.

Such an eventuality would require, I repeat, a sustained rise in demand during most of 1960. Business, Government, and consumers would all have to contribute to this rising demand. So far as business spending is concerned, it can be said with some measure of confidence that capital spending will continue to rise at least until late in 1960. Not only will 1960's total capital spending be greater than the total for 1959, but each quarter should show a higher total than the preceding quarter.

By late 1960 this sustained expansion could well exceed the previous peak in terms of current dollars; namely, $19.3 billion for plant and $29 billion for producers' durable equipment. (As for the equipment spending component, by the end of last year it had already approached within 5 percent of the previous peak.) In terms of its impact on incomes and thus on expenditures in other sectors, the capital goods upswing could be of major importance. In terms of pressure on capacity of the industries producing capital equipment, a peak current-dollar demand need not necessarily mean either a peak in real demand or an absorption of such excess capacity as exists in the capital equipment industries. However, the greater emphasis of the current upswing on modernization than on expansion implies a greater emphasis on machinery than on construction. Thus, the machinery industries may find their output approaching capacity levels sooner than might be indicated by an analysis of total plant and equipment expenditures. In that case, they, too, would be stepping up their capital spending for expansion purposes.

THE OUTLOOK FOR INVENTORY DEMAND IN 1960

Quantitative appraisals of inventory conditions in the last half of 1959 point uniformly to the conclusion that stocks were substantially below their normal relation to the volume of sales. On the basis of the historical behavior of inventories, a considerable addition to stock in 1960 is a reasonable expectation.

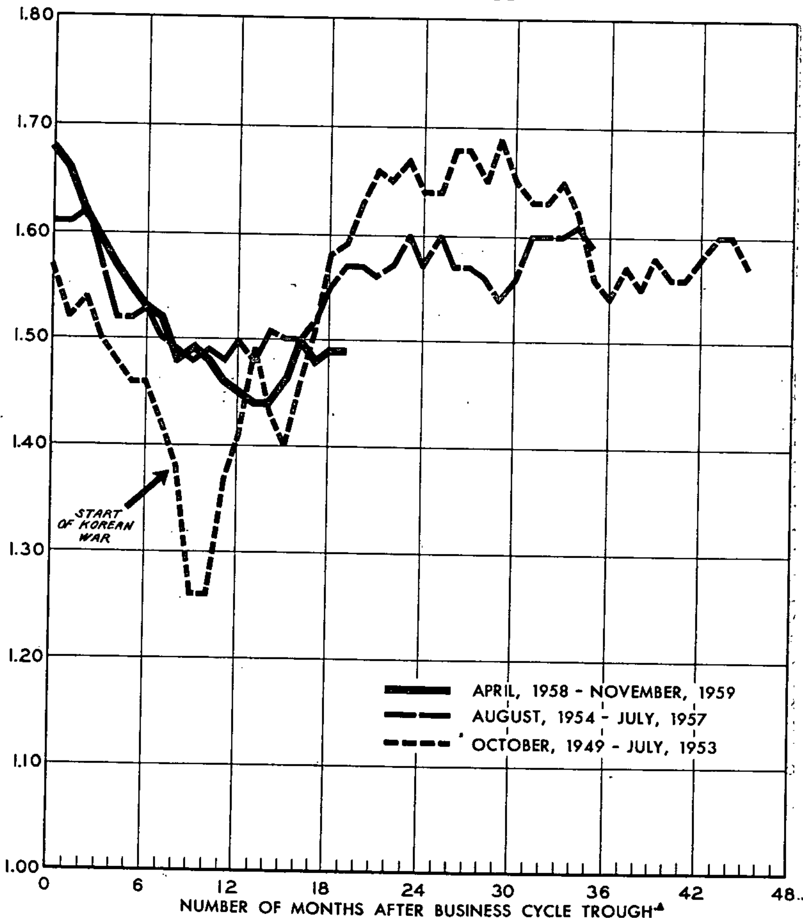
Inventory demand in the first half of 1960

At mid-1959, the inventory-sales ratio in trade and manufacturing industries combined was 1.44; the ratio had declined almost without interruption in the preceding 14 months of recovery in general business conditions, and reached

a level significantly lower than the lowest point reached following the recovery that began in August of 1954 (chart III). By November 1959, the ratio had risen moderately, but the rise was primarily a reflection of reduced sales associated wtih the steel strike and its impact on deliveries in the automobile and other hard goods industries. Even at this artificially reduced sales level, the inventory-sales ratio in November 1959 was substantially lower than the ratio prevailing at a comparable point in time in the last two recoveries, and the ratio has doubtless subsided further since November as shipment rates have recovered.

Chart 3

THE INVENTORY - SALES RATIO FOR TRADE & MANUFACTURING IN THREE POSTWAR EXPANSIONS

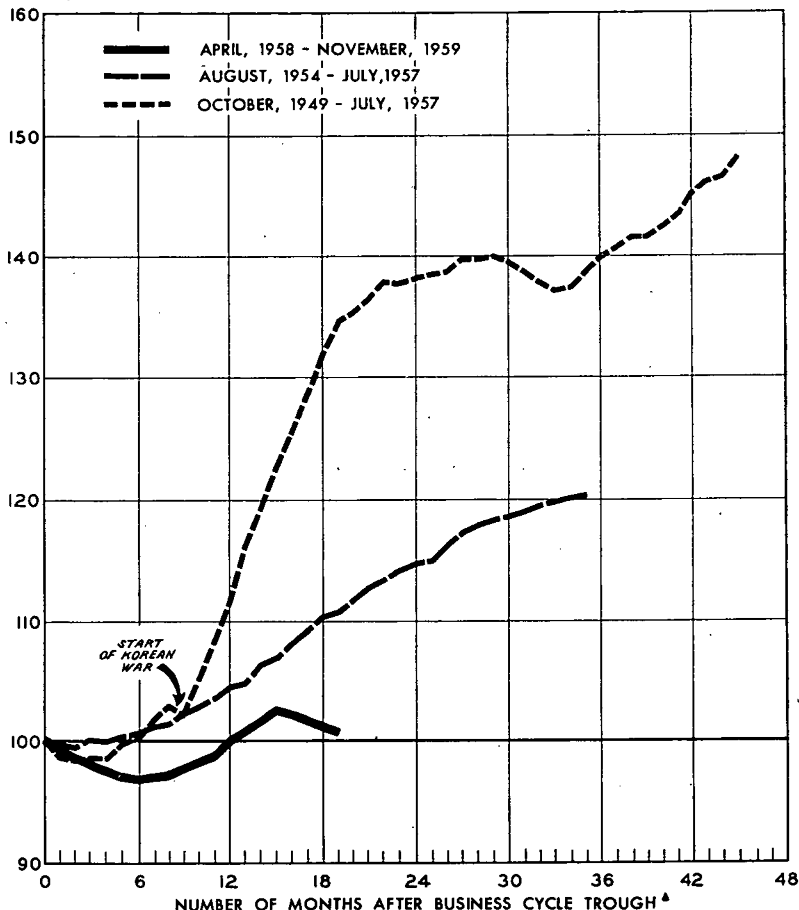


▲OCTOBER, 1949; AUGUST, 1954; APRIL, 1958

SOURCES: NATIONAL INDUSTRIAL CONFERENCE BOARD; DEPARTMENT OF COMMERCE

CHART 4

TRADE AND MANUFACTURING INVENTORIES IN THREE POSTWAR EXPANSIONS



Viewed in absolute terms (without regard to the associated volume of sales), the change in business inventories in the 19 months since the beginning of recovery in April 1958 has been almost negligible (chart IV). As comparable points in the past two recoveries, the book value of inventories had expanded by over 10 percent (following the 1954 trough) and about 35 percent (following the 1949 trough: in this instance, the period includes the start of the Korean war, and about half of the increase in book value of inventories reflected rising prices). Thirty-two months after the beginning of the two previous expansions (a period that corresponds in length to the period from April 1958 to the end of 1960), inventories had risen by about 20 percent and about 38 percent. Viewed both in absolute terms and relative to sales volume, the level of inventories at the close of 1959 appears to have been substantially below normal, and substantially below the level they might be expected to reach in the course of a typical business cycle expansion.

A high degree of correlation exists between inventory-sales ratios for trade and manufacturing industries at a given point in time and the rate of change in inventories in the ensuing 6 months. Historically, the inventory-sales ratio prevailing in November 1959 is associated with an increase in the book value of inventories amounting to over 5 percent in the next 6 months. This would suggest an accumulation in the neighborhood of $5 billion between now and mid-1960, or an annual rate of accumulation of $10 billion. This figure is before inventory valuation adjustment; on the assumption that wholesale prices will rise at about 2 percent per annum during 1960, the inventory valuation adjustment would amount to about $2 billion, and the remaining $8 billion would appear as a positive change in trade and manufacturing inventories in the GNP account. This increase would normally be associated with an increase of over a half billion dollars in nonfarm inventories other than trade and manufacturing: the total GNP figure for nonfarm inventory change might thus approach $9 billion.

In addition to the influence of inventory-sales ratios, the behavior of inventories appears to be related to the relationship of new orders to sales. The inventory-sales ratio and the new orders-sales ratio prevailing in late 1959, taken together, have been associated with 6-month increases in inventories ranging from about 3 percent to about 9 percent, and averaging a little less than 5 percent (chart IV). Treating both factors at the same time thus also suggests an expansion of the book value of inventory at about an $8 billion to $9 billion rate in the first half of 1960.

Inventory demand in 1960 as a whole

Mathematical forecasting of aggregate inventory behavior cannot be extended more than about 6 month into the future. For the last half of 1960, the prospective level of inventory may be viewed as a product of two assumptions covering the then-prevailing sales rate, and the then-prevailing inventory-sales ratio. On the conservative assumption that business sales in late 1960 will be approximately at the levels prevailing prior to the steel strike, and on the assumption that the inventory-sales ratio in late 1960 will approximate its level at the peaks of the last two business expansions, the implied increase in the book value of inventories for 1960 as a whole is roughly $9 billion. With the same sales assumption, but with the inventory-sales ratio assumed to be at approximately the level reached 32 months after the two previous business cycle troughs, the implied annual accumulation is about $11 billion. Assuming only a continuation into 1960 of the abnormally low sales rate prevailing in November 1959, a return to the range of inventory-sales ratios that has prevailed near the peak of the two preceding business cycles would yield an accumulation of about $5 billion.

Inventories in durables manufacturing

In the durables manufacturing industries, where a substantial portion of total inventory fluctuation normally occurs, inventory levels are closely associated with sales volume in the preceding several months. Calculated inventory series, projected several months into the future on the basis of existing sales data, suggest that actual inventories are below their relationship to sales trends, and that rapid accumulation should be expected over the near term. This is true even if the actual (depressed) sales rates of the strike period are inserted into the equations; it is spectacularly true if the sales rates preceding the strike are used. These calculations, which are done by stage of fabrication, indicate that the shortage of inventories in these industries is concentrated in goods in process, where inventory changes are largely determined by objective rather than subjective considerations. Moderate accumulation is also indicated for purchased materials inventories and finished goods.

While virtually any quantitative approach to the trend of inventory demand in 1960 will point to the probability of a high rate of accumulation, opinions about inventory reported by specialists in inventory analysis and by businessmen themselves tend to stress moderation.

Louis Paradiso, who covered the subject of inventory conditions in the Conference Board's Economic Forum meeting on "The Business Outlook for 1960," calculated a $10 billion requirement for additional inventories in 1960, but modified his forecast to $6 billion, partly on the basis of the dampening effects of high interest costs. In Mr. Paradiso's model, the $6 billion accumulation for the year as a whole would be the result of an $8 billion rate of accumulation in the first half, and about a $4 billion rate in the second half.

The expectation that the rate of accumulation will fall in the second half is shared by many other published forecasts. A survey conducted by Dun's Review indicated that accumulation will be "substantial" in the first half and not as great in the second half, as steel stocks reach satisfactory levels. The findings suggested that inventory-sales ratios in manufacturing and in wholesale and retail trade will remain relatively low throughout the year as businessmen pursue a cautious inventory policy.

The Business Survey Committee of the National Association of Purchasing Agents takes a similar view. The members of the association surveyed look for a relatively short buying rush of perhaps 3 to 4 months' duration, and a much more moderate rate of accumulation thereafter.

A survey of business intentions conducted by the National Industrial Conference Board found that tighter control over cash flow is being exercised by a significant proportion of companies participating in the survey, for the purpose of conserving cash under conditions of tight money and high borrowing costs. A frequently mentioned device for conserving cash was tighter inventory control.

In addition to the effects of high interest costs, two other factors that may act to moderate inventory demand in 1960 are (1) the behavior of prices and (2) the probable mix of production activity among manufacturing industries.

(1) Price movements and inventory policy are positively related, since price trends tend to stimulate anticipatory action to maximize inventory profits or minimize inventory losses. The stable behavior of prices over the past seven quarters of recovery suggests that anticipatory buying of inventories to beat price increases may not be present in 1960 in the same degree as in past comparable periods.

(2) The mix of activity in manufacturing affects aggregate inventories mainly because two manufacturing industries—machinery and transportation equipment—are inventory-intensive; that is, they normally operate at relatively high relationships of high inventory to sales. If these industries are less conspicuous in 1960 than in earlier expansions, the general inventory-sales ratio for all business may not rise to the levels experienced at comparable points in the past. In particular, the two industries involved here produce much of the hard goods for the defense sector; the present and foreseeable rates of defense ordering suggest little, if any, accumulation of defense inventory.

Despite these qualifications, substantial additions to total business stocks seem to be in prospect in 1960. The probabilities strongly favor an accumulation for the year as a whole in the neighborhood of $8 billion, on a gross national product basis; the rate may be moderately higher than this in the first half of the year, and moderately lower in the second half.

It should be added that, as with other demands entering into total national expenditures, the course of inventory demand is not independent of the behavior of the other sectors of the economy. If demands for plant and equipment and automobiles justify the generally favorable expectations now held for these markets, it seems altogether unlikely that accumulation will bring inventories to an excessive level by midyear; and inventory demand is hardly likely to reverse at any point in the second half. Phrasing the inventory outlook this way is useful because it stresses the dominant role of end-product demands in the year ahead. If these demands are as strong as they now appear to be, even substantial inventory accumulation in 1960 need not be excessive, speculative, or dangerous; it will simply be a necessary concomitant of higher operating rates and sales volume.

The CHAIRMAN. We will next hear from Mr. George Cline Smith, of the F. W. Dodge Corp., on the outlook for housing construction and consumer expenditures.

STATEMENT OF DR. GEORGE CLINE SMITH, VICE PRESIDENT AND CHIEF ECONOMIST, F. W. DODGE CORP.

Mr. SMITH. Mr. Chairman, first I would like to touch briefly on construction as a whole, this being one of the Nation's largest fabricating industries. In the past 2 years, of course, the construction industry, in dollar volume, has been at record levels. However, the contracts for new construction on which we report reached a peak

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in the middle of 1958. They bumped along near that ceiling, reaching a new high in April of this year, and then have tended to slide down gradually through the remainder of 1959. This might, of course, be partly due to the steel strike, but it is very difficult to determine the precise cause.

For 1959 as a whole, total construction contracts set a new alltime record. This is hardly remarkable, because they have done this each year since 1946, despite the three postwar recessions and the ups and downs in individual categories of construction.

But in late 1959, several sharply divergent movements were showing up in different construction categories. For instance, contracts for two of the largest construction types, housing and highways, had declined. In the fourth quarter of 1959, housing contracts were running 5 percent below the corresponding quarter of 1958, and highway contracts in the fourth quarter of 1959 were down 35 percent below the fourth quarter of 1958.

On the other hand, a very pronounced upward movement appeared in contracts for new industrial buildings. In the fourth quarter they were up 66 percent over the fourth quarter of 1958.

We expect, in our own forecast, that total construction contracts in 1960 will show a decline of about 1 percent below 1959. This decline would hardly be worth noting, except that it will be the first such decrease in total contracts in any year of the postwar period. In my prepared statement I have a table which gives the forecasts for various individual categories.

I have been asked to comment specifically on housing. Housing starts and housing contracts have shown strong cyclical movements in the postwar period. These cycles have shown a pronounced inverse relation to interest rates, of course, and therefore they have also been somewhat out of phase with cycles of prosperity and recession.

There are many who believe that housing should be used as a balance for the rest of the economy, and it is obvious that it has tended to serve in this capacity. The question has been raised, however, whether it is (*a*) fair to those in labor and management whose incomes are tied to this industry to make use of it in such a manner; and (*b*) wise to interrupt the progress that might otherwise be made in such a social necessity as better housing.

I am firmly convinced that the principal, if not the only important cause of the cyclical movements of housing in the postwar period, is the interest rate structure—and only in the FHA–VA sectors of housing at that. Demand for new housing has remained steady, year after year, as far as I can make out. Regardless of interest rate changes, conventionally financed housing has not shown any significant cycle. The entire roller coaster in housing starts is accounted for by the FHA–VA insured programs.

It is easy to deduce that the solution to the housing cycle lies either in maintaining steady and relatively low interest rates, or in making the FHA and VA rates flexible enough to compete in the money markets. The first solution, in my opinion, is incompatible with our economic system. The latter solution has been requested by the President again in his messages to Congress.

Without going into policy matters at this point, suffice it to say that in 1960, interest rates promise to remain high, and VA mortgages and to a lesser degree FHA mortgages will be relatively unattractive.

There is general agreement that despite the general prosperity expected in 1960, housing starts will therefore decline. If housing activity is indeed a leading economic indicator, this trend may be a bad omen for the economy in 1961. The Congress, of course, may or may not take actions which will reverse the trend in 1960.

I am convinced that basic demand for housing remains strong. Our population growth of around 3 million a year requires nearly a million new houses annually; and on top of this we have requirements for replacement.

We have no adequate current data on replacement of houses. A typical guess is that about 300,000 units a year are replaced because of obsolescence or catastrophe or such other causes as land clearance for highways and other projects.

At first glance, 300,000 seems like an enormous figure, but in perspective, it is tiny. Replacement of 300,000 units a year is a replacement rate of less than six-tenths of 1 percent of our housing stock, and at this snail's pace it would take somewhat over 180 years to replace our existing housing stock. If the Nation is not to be housed in dwellings that are, on the average, continually older and more decrepit, this replacement rate has to be substantially increased.

The only conclusion I can come to is that even in our peak years, we have been underbuilding housing in relation to the Nation's needs.

Because demand pressure remains great, the outlook for housing activity in the 1960's is excellent. Our own forecast of 1,240,000 public and privately financed nonfarm units for 1960 is somewhat higher than the typical forecast now being presented by those who follow the industry closely, but we are inclined to feel that general prosperity and the increasing emphasis on conventionally financed housing will partially offset the declines that tight money will produce in the Government-guaranteed sectors.

If interest rates ease a little, or other actions are taken by the Government, housing activity in 1961 could well improve. A slight business setback would not produce a decline in housing, if recent history is any guide; the converse is more likely.

Prospects for increased population growth in the 1960's of course, seem to insure a continually rising level of housing activity throughout the decade. The problem is whether we will build enough housing to meet our real needs.

I have also been asked to comment on consumer spending. Because personal consumption expenditures account for almost two-thirds of the GNP, obviously I can only treat this with a very broad brush.

Personal consumption expenditures, both in real and dollar terms, reached a record high in the fourth quarter of 1959. On a seasonally adjusted annual rate basis, the fourth quarter total was $317 billion. This represented a rise of 10 percent over the prerecession peak in the third quarter of 1957, and a rise of 75 percent in the past 10 years.

These increases are partly attributable to population growth, and partly due to inflated prices. If personal consumption expenditures are measured per capita, and in dollars of constant purchasing power, to take care of these two effects, we find that living standards, as represented by consumer spending, have made a much smaller, but nonetheless genuine, gain. On this basis, according to the figures presented in the report of the President's Council of Economic Advisers, real

personal consumption expenditures, per capita, have increased somewhat less than 3 percent since the prerecession peak in 1957, and about 19 percent in the past 10 years.

There seems to be no doubt at all that personal consumption expenditures will increase during 1960. Typical estimates for the year range around $330 billion. To reach this figure would imply an annual rate in the fourth quarter of 1960 of as much as $340 billion. Allowing for population growth of 3 million, and price increases of 2 percent (probably a high estimate) this would represent a very satisfactory increase in living standard (personal consumption expenditures in constant dollars per capita) of about 3 percent during the 1 year.

In past years there have been some significant changes in the pattern of consumer spending. We find, for instance, that the greatest increase in percentage terms has been in services; the second largest increase in durable goods; and the smallest increase in nondurable goods. Services, of course, form a somewhat misleading category, because a great part of the service category is made up of expenditures for housing, some of which are not expenditures at all but simply imputed rental value of owner-occupied housing.

It seems very unlikely that any radical changes will occur in the overall pattern of consumer spending in 1960. All of the major categories should increase. The imputed rent item will continue to boost the services outlay, reflecting a big addition to the Nation's housing stock last year and a continued substantial addition this year.

Spending for consumer durables will be stimulated, of course, by automobile sales. The auto industry is talking in terms of 6½ to 7 million new car sales in 1960, although one automobile economist has noted that a 7 million level of sales would require an expansion of $3 billion or more in auto installment credit, and that might well be a limiting factor in a year of tight money.

Consumer spending for nondurables, while increasing, will probably show a smaller rise than other categories. This is in part the continuation of the long-term trend that I noted earlier, and in part it will reflect the prospect of fairly stable food prices.

Food accounts for nearly half of the nondurable purchases, and there is a good possibility that food prices will remain level or at least not rise as much as other consumer prices during 1960. Spending for apparel and for gasoline and oil, which are the other major nondurable categories, should rise somewhat more than food in 1960.

In summary, I think we will almost certainly see new records set in 1960 by the principal economic indicators. The only major segment of the nonagricultural economy which is likely to decline is housing, and I think it is possible that the decline here will turn out to be less than is now generally expected.

Consumer spending and business capital investment will be, as Mr. Gainsbrugh says, the principal factors in raising the economy above the 1959 levels. Capital investment is likely to go on increasing into 1961, and housing activity may also increase in 1961 if money rates ease or, of course, if certain actions are taken by Government, and that would help to offset any tendency of the economy to turn downward in 1961.

The CHAIRMAN. Thank you very much. Your entire prepared statement will be included in the record.

(The prepared statement of Dr. George Cline Smith is as follows:)

STATEMENT OF DR. GEORGE CLINE SMITH, VICE PRESIDENT AND CHIEF ECONOMIST, F. W. DODGE CORP.

COMMENTS ON THE GENERAL ECONOMIC OUTLOOK FOR 1960

With only a few significant exceptions, the economic outlook for the remainder of 1960 appears quite good. In the past month, in fact, certain developments have occurred which make the picture seem considerably brighter than it did at the beginning of the year.

One of these was the settlement of the steel strike, prospects for which appeared very gloomy right up until the settlement was announced.

Another is the apparent improvement in prospects for solution of other labor-management problems which had threatened to interrupt production during 1960.

And a third recent development is the improved outlook for Federal finances, according to the President's budget message. Budget forecasting, particularly on the revenue side, is an inexact science, but the estimates presented for a small surplus in the current fiscal year and a substantial surplus next year offer hope for debt or tax reduction and some easing of the pressure on money rates.

The estimated surplus of $4.2 billion for 1961, however, depends in part on additional taxes and higher postal rates, which may or may not be granted by the Congress. The remainder of the estimated surplus assumes higher revenues from existing sources, which will in turn depend very heavily upon the state of the economy in late 1960 and 1961. All of the surplus results from diverting more money from the public into the Treasury. None of it comes from reduction of Federal spending, which is actually scheduled to increase.

Last November, we released the results of our annual poll of leading economists on the business outlook. Subject to the improvements in conditions noted above. I think the collective opinions of the 273 economists participating are still applicable to the present situation, particularly since the forecasts were based on the correct assumption that the steel stoppage would not continue into 1960.

Briefly, the opinions of the economists may be summarized as follows: First, the general expectation is that the principal indicators, such as gross national product and personal consumption expenditures, will rise steadily through 1960. But two cautions should be noted: First, the economists are not nearly as unanimous in this expectation as they were a year earlier, when they looked ahead to 1959. Second, there is a general feeling that the rate of growth may taper off later in 1960. And, while the economists were not asked for projections into 1961, many commented on the possibility of some downturn or readjustment in that year.

On two subjects the 273 economists were nearly unanimous: They expect inflationary forces to continue pushing prices moderately upward and they expect money to remain tight.

The median estimate of the economists is that GNP will reach an annual rate of $514 billion by the fourth quarter of 1960; that the Federal Reserve index of industrial production (old basis) would reach 160 in June and remain at that level through the rest of the year; and that personal consumption expenditures in 1960 would total $325 billion. They also expect the consumer price index to reach 127 by next December, and the wholesale price index to go to 121.

My personal impression is that these estimates still stand up reasonably well as to the probable pattern but that they may be somewhat conservative in the amounts of increase in all the indicators. including prices. This seems particularly true in the light of the recent improvements in the outlook.

The principal weak spot in the nonagricultural sector of the economy in 1960 is housing. about which more will be said later. Indeed, this is almost the only major weak spot in the short-term outlook.

Longer range, there are of course many more problems. I think it is fair to say, however, that the fear of severe depression, which has hung over many of our people like a pall since the 1930's. is beginning to dissipate. We have reason to hope that increased economic sophistication will enable us to understand what makes the economy sick, and how to keep it well.

I would like to take this occasion to compliment the Joint Economic Committee for its tremendous contribution in this direction. We have learned much from the material the committee and its competent staff have developed.

Much more remains to be done. In addition to the more obvious problems, such as inflation and unemployment, on which the committee is working, I would respectfully suggest that some intensive studies are needed aimed at ironing out two of the more violent cyclical movements still remaining in the economy. These are the roller-coaster movements to be found in residential building and in business spending for new plant and equipment. In the recent past, cycles in these two areas have fortunately tended to offset each other. If they should coincide, particularly while declining, we might face some serious problems.

A great deal more could be said about the outlook in general. However, I have been asked to comment specifically on construction and on consumer spending.

Recent trends in construction

In the past 2 years, dollar volume of construction activity has been at record levels. A glance at the attached chart of the seasonally adjusted index of construction contracts[1] shows that a high level was reached in mid-1958 which has tended to serve as a ceiling ever since. Some evidence of a declining trend may be deduced from the figures for the last few months of 1959.

For 1959 as a whole, total contracts set a new all-time record. This is hardly remarkable, because they have done this each year since 1946, despite the three postwar recessions and the ups and downs in various categories of construction.

In late 1959, several sharply divergent movements of individual categories had begun to show up. Contracts for two of the largest construction types, housing and highways, had declined; in the fourth quarter of 1959, housing contracts were 5 percent below the corresponding quarter of 1958 and highway contracts were down 35 percent. On the other hand, a very pronounced upward movement appeared in contracts for industrial buildings; in the fourth quarter, they were up 66 percent over the fourth quarter of 1958.

Contracts for school buildings, which constitute the fourth largest of the major construction categories (exceeded only by residential, highways, and commercial buildings) underwent their first substantial postwar decline in 1959, down 8 percent from 1958. Commercial building contracts set new records in 1959, up 9 percent over 1958, with stores up sharply and offices down moderately.

Construction in 1960

We expect that total construction contracts in 1960 will show a decline of about 1 percent below 1959. This decline would hardly be worth noting, except that it will be the first decrease in total contracts in any postwar year. As the attached table indicates, it will be the result of a number of cross trends in individual categories.

We expect that housing contracts in 1960 will decline about 8 percent below 1959 in dollars and about 10 percent in physical volume, as measured by floor area of contracts or in number of nonfarm housing starts.

Nonresidential building in 1960 should be quite strong, with both dollar volume and floor area up about 7 percent. Leading this upward movement will be industrial building, for which we estimate a gain of 20 percent in floor area of contracts.

Heavy engineering should be up about 2 percent in dollar volume of contracts.[2] An upturn in electric utilities, which were quite weak in 1959, will produce this rise. Highway contracts will probably show little change from 1959.

Housing in 1960

Special comment on new housing activity is called for.

Housing starts, and contracts, have shown strong cyclical movements in the postwar period. These cycles have shown a pronounced inverse relation to interest rates, and therefore have also been out of phase with cycles of prosperity and recession.

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[1] Reference is made in this section to construction contracts, rather than to work-in-place, because the contracts serve as anticipatory data, preceding trends in the work-in-place series. There is evidence that the contracts also are useful as advance indicators of general business activity. Two of the well-known "eight leading indicators" of the National Bureau of Economic Research are the Dodge construction contract data on residential building and on industrial-commercial building (floor area).

[2] No physical volume measure is available for heavy engineering, since most heavy engineering projects involve no measurable floor area.

There are many who believe that housing should be used as a balance for the rest of the economy, and it is obvious that it has tended to serve in this capacity. The question has been raised, however, whether it is (*a*) fair to those in labor and management whose incomes are tied to this industry to make use of it in such a manner and (*b*) wise to interrupt the progress that might otherwise be made in such a social necessity as better housing.

I am firmly convinced that the principal, if not the only important cause of the cyclical movements of housing in the postwar period is the interest rate structure—and only in the FHA–VA sectors of housing, at that. Demand as such for new housing has remained steady, year after year, as far as I can make out. Regardless of interest rate changes, conventionally financed housing has not shown any significant cycle. The entire roller coaster in housing starts is accounted for by the FHA–VA insured programs.

It is easy to deduce that the solution to the housing cycle lies either in maintaining steady and relatively low interest rates, or in making the FHA and VA rates flexible enough to compete in the money markets. The first solution, in my opinion, is incompatible with our economic system. The latter solution has been requested by the President again in his messages to Congress.

Without going into policy matters at this piont, suffice it to say that in 1960, interest rates promise to remain high, and VA mortgages and to a lesser degree FHA mortgages will be relatively unattractive. There is general agreement that despite the general prosperity expected in 1960, housing starts will therefore decline. If housing activity is indeed a leading economic indicator, this trend may be a bad omen for the economy in 1961. The Congress, of course, may or may not take actions which will reverse the trend in 1960.

I am convinced that basic demand for housing remains strong. Our population growth of around 3 million a year requires nearly a million new houses annually; and on top of this we have requirements for replacement.

Two things should be pointed out here. First, household formation figures are not a useful guide to housing demand. An increase of 1 million households is statistically the same as an increase of 1 million occupied dwelling units. Net additions to households cannot be made without net additions to the housing stock, or a decline in the very nominal vacancy rate. It is, therefore, entirely possible for a decrease in homebuilding to limit the formation of new households. It is utterly impossible to tell from the statistics whether decreased pressure to form households reduces housing demand, or whether high interest rates, restricting homebuilding, also restrict household formations. For this reason, I believe that the simple population increase figures are more useful as an indicator of basic demand for housing.

Second, there is the matter of replacement of existing stock. We have no adequate current data on replacement. A typical guess is that about 300,000 units a year are replaced because of obsolescence, catastrophe, or such other causes as land clearance for highway and other projects. At first glance, this seems like an enormous figure. In perspective, however, it is tiny. Replacement of 300,000 units a year represents a replacement rate of less than six-tenths of 1 percent of our housing each year. At this snail's pace, it would take more than 180 years to replace our present housing stock. If the Nation is not to be housed in dwellings that are, on the average continually older and more decrepit, this replacement rate must be substantially increased.

The only conclusion I can come to is that even in our peak years, we have been underbuilding housing in relation to the Nation's needs.

Because demand pressure remains great, the outlook for housing activity in the 1960's is excellent. Our own forecast of 1,240,000 public and privately financed nonfarm units for 1960 is somewhat higher than the typical forecast now being presented by those who follow the industry closely, but we are inclined to feel that general prosperity and the increasing emphasis on conventionally financed housing will partially offset the declines that tight money will produce in the Government-guaranteed sectors.

If interest rates ease a little, or other actions are taken by the Government, housing activity in 1961 could well improve. A slight business setback would not produce a decline in housing, if recent history is any guide; the converse is more likely.

Prospects for increased population growth in the 1960's, of course, seem to insure a continually rising level of housing activity throughout the decade. The problem is whether we will build enough housing to meet our real needs.

Consumer spending in 1960

Personal consumption expenditures account for almost two-thirds of the gross national product. Obviously, this subject can only be treated here with a very broad brush.

Personal consumption expenditures, both in real and dollar terms, reached a record high in the fourth quarter of 1959. On a seasonally adjusted annual rate basis, the fourth quarter total was $317 billion. This represented a rise of 10 percent over the prerecession peak in the third quarter of 1957, and a rise of 75 percent in the past 10 years.

These increases are partly attributable to population growth, and partly due to inflated prices. If personal consumption expenditures are measured per capita, and in dollars of constant purchasing power, to take care of these two effects, we find that living standards, as represented by consumer spending, have made a much smaller, but nonetheless genuine, gain. On this basis, according to the figures presented in the report of the President's Council of Economic Advisers, real personal consumption expenditures, per capita, have increased somewhat less than 3 percent since the prerecession peak in 1957, and about 19 percent in the past 10 years.

There seems to be no doubt at all that personal consumption expenditures will increase during 1960. Typical estimates for the year range around $330 billion. To reach this figure would imply an annual rate in the fourth quarter of 1960 of as much as $340 billion. Allowing for population growth of 3 million, and price increases of 2 percent (probably a high estimate) this would represent a very satisfactory increase in living standard (personal consumption expenditures in constant dollars per capita) of about 3 percent during the 1 year.

Consumer spending patterns have undergone sharp changes in the past decade. Percentage increases in the dollar amounts spent for major categories in 1959, as compared with 1949, are as follows:

Services	Up 101 percent.
Durable goods	Up 75 percent.
Nondurable goods	Up 53 percent.

There were even greater differentials among the individual items of these categories. Emphasis on housing and household operation, automobiles and gas and oil increased greatly, at the expense of furniture, food, clothing, and transportation. Percentage changes between 1949 and 1959, in dollars, are as follows:

Gasoline and oil	Up 124 percent.
Housing	Up 111 percent.
Household operation	Up 111 percent.
Automobiles and parts	Up 83 percent.
Furniture	Up 62 percent.
Transportation	Up 54 percent.
Food	Up 49 percent.
Clothing	Up 44 percent.

Housing and household operation, having grown more rapidly than most other major spending segments, accounted for 18.8 percent of personal consumption expenditures in 1959, as compared with 15.3 percent in 1949. This relative growth simply represents a return of housing to the position it occupied in earlier years; the 1959 proportion of total spending which went into housing and household operation was still slightly less than in 1929.

A large proportion of consumer spending, as pointed out in various studies of the National Industrial Conference Board, is relatively fixed in amount, and not subject to rapid change. For example, the largest housing "expenditure" is a purely theoretical concept, the "imputed rental value of owner-occupied dwellings." This is not an actual money payment made by homeowners, very few of whom have even heard of it. Yet this particular item accounts for more than a fifth of the "services" category of personal consumption expenditures.

It seems unlikely that any radical changes will occur in the overall pattern of consumer spending in 1960. All major categories should increase. The "imputed rent" item will continue to boost the services outlay, reflecting the addition to the Nation's total housing stock made in 1959, and smaller, but still significant additions being made this year.

Spending for consumer durables should be stimulated by automobile sales. The auto industry is talking in terms of 6.5 to 7 million new car sales in 1960, although one automobile economist has noted that a 7-million level of sales

would require an expansion of $3 billion or more in auto installment credit, which might well be a limiting factor in a year of tight money.

Consumer spending on nondurables, while increasing, will probably show a smaller rise than other categories. This is in part the continuation of the long-term trend noted earlier, and in part will reflect the prospect of fairly stable food prices. Food accounts for nearly half of nondurable purchases, and there is a good possibility that food prices will remain level, or at least not rise as much as other consumer prices, during 1960. Spending for apparel and for gasoline and oil, the other major nondurables, should rise somewhat more than food in 1960.

Summary

We will almost certainly see new records set in 1960 by the principal economic indicators. The only major segment of the economy likely to decline is housing, and it is quite possible that the decline here will turn out to be less than is now generally expected. Consumer spending and business capital investment will be the principal factors in raising the economy above the 1959 levels. Capital investment is likely to go on increasing into 1961, and housing activity may also increase next year if money rates ease or if certain actions are taken by government. This would help to offset any tendency of the economy to turn downward next year.

Estimated dollar volume of construction contracts

[48 States; figures in millions of dollars]

Classification	Year 1959	Year 1960, estimate	Percentage of change [1]
Nonresidential	11,387	12,185	+7
Residential	17,150	15,780	−8
Total building	28,537	27,965	−2
Public works and utilities	7,732	7,885	+2
Total construction	36,269	35,850	−1
Private ownership	25,201	24,780	−2
Public ownership	11,068	11,070	0
Dodge index (1947–49=100)	265	262	−1

[1] Percentage rounded to nearest whole number.

Source: Estimates by economic staff, F. W. Dodge Corp. Revised from earlier estimates on the basis of final figures for 1959.

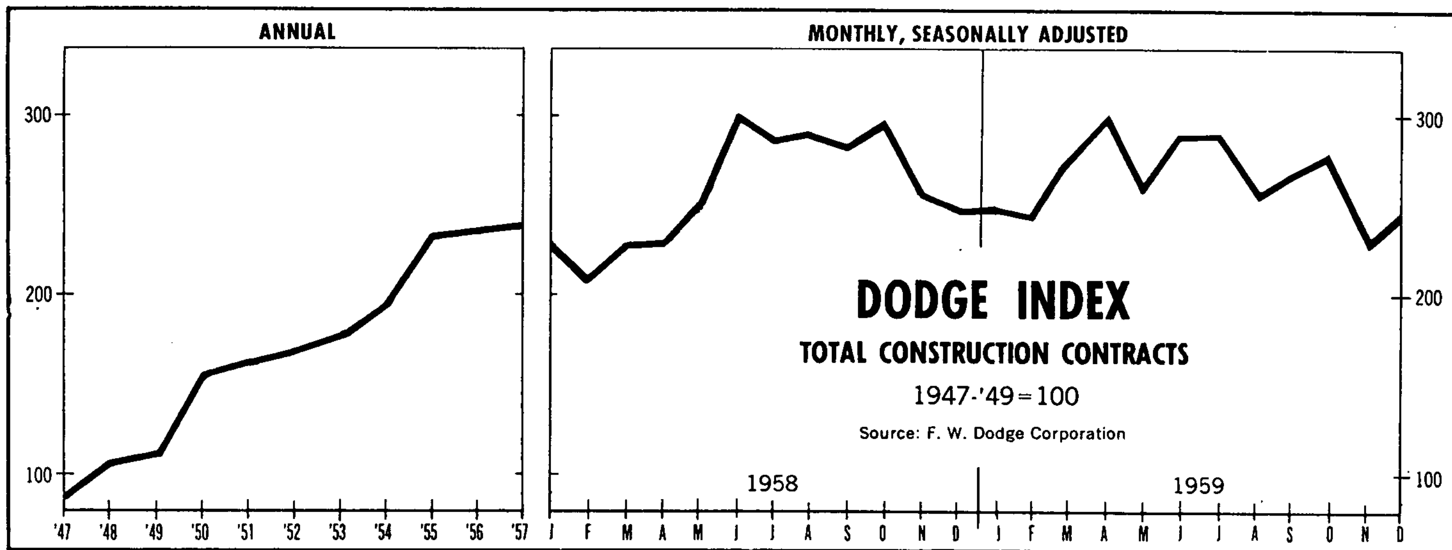
Estimated physical volume of building contracts

[48 states; figures in millions of square feet]

Building classification	Year 1959	Year 1960 estimate	Percentage change [1]
Commercial	281	298	+6
Manufacturing	158	190	+20
Educational and science	181	185	+2
Hospitals and institutions	38	39	+3
Public	34	35	+3
Religious	54	57	+5
Social and recreational	43	46	+7
Miscellaneous nonresidential	35	35	0
Total nonresidential	824	885	+7
Residential	1,512	1,360	−10
Total building	2,337	2,245	−4
New nonfarm dwelling unit starts (Census Bureau basis)	1,376,900	1,240,000	−10

[1] Percentages rounded to nearest whole number.

Source: Estimates by economics staff, F. W. Dodge Corp. Revised from earlier estimates on the basis of final figures for 1959.


ANNUAL
MONTHLY, SEASONALLY ADJUSTED
DODGE INDEX
TOTAL CONSTRUCTION CONTRACTS
1947-'49=100
Source: F. W. Dodge Corporation
300
200
100
'47 '48 '49 '50 '51 '52 '53 '54 '55 '56 '57
1958
1959
J F M A M J J A S O N D
J F M A M J J A S O N D

The CHAIRMAN. The discussion will be continued by another old friend, Mr. Peter Henle, assistant director of research, AFL-CIO.

STATEMENT OF PETER HENLE, ASSISTANT DIRECTOR OF RESEARCH, AFL-CIO

Mr. HENLE. Thank you, Mr. Chairman.

I have a brief statement here, which I will try to read within the time limit.

Nineteen hundred and fifty-nine was a year of recovery in the job market as well as the product market. Over the year, employment expanded by 1,700,000 (December 1959, over December 1958) and the rate of unemployment seasonally adjusted at the end of the year was 5.2 percent, down from 6.1 percent in December 1958.

For the year as a whole, the data are somewhat more difficult to evaluate because of the steel strike. For a 4-month period—August-November—varying numbers of workers in steel-using industries were on laid-off status and thus properly counted as unemployed by the monthly report on the labor force. The strikers themselves were not considered unemployed unless they were actively seeking work elsewhere. By the time of the December survey, however, most of these workers had returned to their jobs so that the December figures closely reflect conditions that would have prevailed had the strike not taken place.

Without minimizing today's improved outlook for employment, it is clear that the recovery in the job market is by no means complete. In fact the 1958 recession has left the economy with a higher level of unemployment than either of the two previous postwar recessions. Twenty months after the trough of the 1949 recession unemployment rates were close to the 3-percent mark; 20 months after the 1954 recession they were close to the 4-percent mark. This year, however, 20 months after the low of April 1958—that brings you to December 1959—unemployment rates were only down to the 5-percent level. The more detailed figures are attached as table I.

For the months immediately ahead there is every indication that the recovery will continue in vigorous manner, stimulated by industry's effort to replenish its stocks of steel. The increasing output of the national economy will in turn be translated into continuing improvements in employment. At least for the first half of the year we can expect a continued rise in the number of jobs and in the level of income that these jobs will generate.

However, with regard to unemployment, it must be said that the outlook is considerably less favorable than that for employment. It must be remembered that an increase in the number of jobs is not necessarily reflected in a decline in unemployment. The additional employment can come not only from the ranks of the unemployed but also from the ranks of those who previously have not been in the labor force.

In recent years, the increase in the labor force has ranged from a low of 350,000, in 1956-57 to a high of 1,500,000 in 1955-56. In 1959 the total labor force increased by 662,000 over the previous year, although a substantially greater rate of increase occurred in the latter part of the year. In December the total labor force was 1.1 million above the previous year.

For 1960 the increase in the labor force is likely to be larger than for 1959 for two reasons:

1. We have now reached the point where during each succeeding year a larger number of young people are reaching the ages at which they enter the labor force. Thus projections of the labor force based on population changes point to gradually increasing additions to the labor market. This trend will accelerate substantially over the next few years. See table II.

2. Under our present survey methods, increases in the labor force tend to fluctuate with conditions in the job market. For example, when jobs are most plentiful, many married women and young people become more active jobseekers and are counted as employed or unemployed as the case may be. In years of recessions, these same people, knowing fewer jobs are available, are likely to curtail their jobseeking and spend their time as housewives or students and thus be reported as not in the labor force.

Partly as a result of the 1958 recession, the labor force has fallen somewhat below the level that was expected on the basis of past trends. Consequently, with the continuing recovery, it is likely that an increasing number of people will be looking for jobs.

The Labor Department has done considerable work in projecting future labor force trends. Their figures indicate that the labor force is expected to grow by 1,045,000 in 1960. If in addition enough people are attracted to the labor force to bring it up to the projected trend line—and we are now somewhat below that trend line—the increase for the year would be 1,600,000. It is probable that the increase in the labor force for 1960 will fall within these two figures; as a guess, I would say somewhere around 1,200,000.

The expected increase in the labor force is the major reason why the prospects for improvement in unemployment cannot be considered as bright as those for employment. Many of the additional jobs that will be generated by the economy's strength during 1960 will be filled by the expected increase in the labor force rather than by those currently unemployed.

Another imponderable in the employment outlook is the rate at which the productivity of the national economy will increase. While a high rate of productivity of course is to be welcomed, it may have the shortrun effect of allowing substantially higher levels of output to be reached with fewer workers on the job.

Thus for the continuing improvement in the economy to have a substantial effect on the level of unemployment, it will be necessary first for the rate of improvement to be higher in percentage terms than the increase in productivity and, secondly, beyond this to be more than enough to absorb the expected increase in the labor force.

While some improvement in unemployment can be expected during 1960, particularly during the early months, it is difficult for this observer to see the rate of unemployment falling below the general range of 4.7 to 5.2 percent of the labor force. Perhaps, if the more optimistic forecasts of activity in the latter part of the year turn out to be correct, the unemployment rate in late 1960 will fall to 4½ percent.

In terms of the generally desired levels of unemployment, today's 5 percent rate and even a possible rate later in the year of 4½ percent are excessive both from a standpoint of welfare and from the

viewpoint of economic growth. After all, just about the most important test of any economy is how well it provides job opportunities for those able, willing, and seeking to work. The American economy may not exactly be flunking this test, but its classroom grades have been slipping steadily over the past few years and are now barely passable.

Moreover, there are a number of additional reasons why today's rate of unemployment poses serious long-range problems for the economy.

Here I list a number of points. I will just go through them rather sketchily.

1. Today's unemployment is affecting a greater number of family breadwinners. In a number of respects the character of unemployment has shifted somewhat in recent years. In the early postwar years, unemployment was not very serious in terms of its level. Moreover, a large proportion of unemployed workers were among the so-called marginal groups in the labor force, particularly young people and women. If the family breadwinner was laid off, the level of demand in the economy soon made it possible for him to return to his old job or to find an alternative job.

This pattern is now changing. Since 1951–53, the unemployment rate for men over 25 years of age has almost doubled. To some extent this results from the long-term decline in the level of demand for such major industries as coal and textiles. To some extent it reflects the accelerated movement of plants to new locations, frequently away from urban centers. It also partially reflects the impact of more modern technology. In any event, unemployment among family breadwinners has definitely increased.

2. To an increasing extent today's unemployed workers have a harder time finding a new job. The monthly report on the labor force provides a simple breakdown of all unemployed workers by the length of time during which they have been unemployed. The extent to which long-term unemployment (unemployment for 15 weeks or longer) has been growing is indicated in table III. It can be readily seen that the proportion of unemployed workers who have had to look for new jobs as long as 15 weeks or more has risen from a level of 11 to 14 percent in 1951–53 to 27 percent in 1959.

3. The number of pockets of severe unemployment is still quite large.

My paragraph here gives the figures for last November, but over the weekend the Labor Department released its report for January, and these figures indicate very little change over November, although they are expecting some improvement over the next few months.

In January there were 31 major industrial areas and 107 smaller ones listed as suffering a substantial labor surplus with unemployment of 6 percent or more. This is a substantial rise over the prerecession level in January 1957, of only 19 major and 57 smaller areas.

4. While there is a continuing demand for different types of skills, the skills of the unemployed, by and large, are not in demand. A familiar pattern in the American economy has been the shift both in terms of output and employment away from the so-called goods-producing industries such as agriculture, manufacturing, construc-

tion, and mining, to the service-producing industries such as trade, service, finance, insurance, and government. By and large, it is the second group of industries where employment and output are increasing most sharply, while in the first group of industries employment has remained relatively stable or has been declining.

The same type of comparison can be drawn on the basis of occupation. It is the so-called white collar types of jobs for which demand is highest and which have been steadily increasing in recent years. On the other hand, the total number of manual workers has remained relatively stable.

Unfortunately, the occupational and industrial characteristics of the unemployed, however, contrast sharply with this emerging pattern. The unemployment rate in December for professional and technical workers, for example, was 1.4 percent of the work force; for managers, officials, and proprietors, 1 percent; for clerical workers, 3.2 percent; and for sales workers, 2.8 percent. These low rates contrast with the rate of 14.1 percent for laborers, and 7.3 percent for operatives and kindred workers. Thus those occupations and industries for which there is little demand are precisely the ones which dominate the unemployed group. Clearly, this vastly complicates the difficulties of providing job opportunities for the unemployed, and raises serious questions about the need for adequate training and retraining facilities in our economy.

5. The American economy is not growing at a rate fast enough to absorb the normal additions to the labor force. Looking back over the last business cycle, say a 4-year period, it is clear that the American economy has not been doing a very good job of providing jobs for the yearly additions to the labor force. From December 1955 to December 1959, the growth in the civilian labor force was 2.7 million, while total employment increased by only 1.8 million, leaving close to 1 million people who have in effect been added to the ranks of the unemployed. Of course, this is not to say that this 1 million never found jobs during this 4-year period, but what is clear is that during these 4 years the economy's expansion was able to employ only two-thirds of the additions to the labor force.

This issue will be compounded in future years as greater numbers of young people reach jobseeking age. The relatively poor growth record of the past 4 years underscores the need for more rapid growth in the future to absorb these new workers.

In conclusion let me stress that I do not wish to be unduly gloomy about the outlook for unemployment. Certainly, if, as is generally expected, the Nation's economy continues to expand during 1960, unemployment rates will tend to fall. Against this tendency must be placed the probabilities for a greater than average increase in the labor force and a substantial increase in productivity. In any event, recent trends in the level and composition of unemployment raise serious questions for the Nation's policymakers.

The CHAIRMAN. Thank you very much. The tables which accompany your paper will be included in the record.

(The tables referred to are as follows:)

TABLE I.—*Course of unemployment in 3 postwar recessions (seasonally adjusted rates)**

Months in Relation to Trough of Recession	1948-1951	1953-1956	1957-1959	Adjusted for Steel Strike 2/
		2.6 Jul.1953		
		2.6		
-11	4.0 Nov.1948	2.9		
-10	4.2	3.1		
- 9	4.5 1949	3.5	4.2 Jul.1957	
- 8	4.7	4.5	4.3	
- 7	4.9	4.8 1954	4.5	
- 6	5.2	5.3	4.7	
- 5	6.2	5.7	4.9	
- 4	5.9	5.8	5.0	
- 3	6.4	6.0	5.8 1958	
- 2	6.7	5.4	6.7	
- 1	6.5	5.7	7.0	
Trough - 0	7.8 Oct.1949 1/	6.0 Aug.1954	7.5 Apr. 1958	
+ 1	6.7	6.1	7.2	
+ 2	6.8	5.7	6.8	
+ 3	6.7 1950	5.4	7.3	
+ 4	6.4	5.0	7.6	
+ 5	6.3	4.9 1955	7.2	
+ 6	5.8	4.8	7.1	
+ 7	5.7	4.7	5.9	
+ 8	5.3	4.8	6.1	
+ 9	5.0	4.3	6.0 1959	
+10	4.5	4.1	6.1	
+11	4.5	4.1	5.8	
+12	4.1	4.3	5.3	
+13	4.3	4.2	4.9	
+14	4.3	4.4	4.9	
+15	4.7 1951	4.2	5.1	
+16	3.5	4.1	5.5	5.3
+17	3.4	4.0 1956	5.6	5.3
+18	3.1	4.1	6.0	5.4
+19	3.1	4.3	5.6	5.1
+20	3.3 June 1951	4.1 Apr.1956	5.2 Dec.1959	

* New definitions
[1] Rate exaggerated by coal strike
[2] Estimated by AFL–CIO Research Department

Source: U.S. Department of Labor

TABLE II.—*Annual increase in total labor force, 1951–75*

Year	Total labor force: Actual	Total labor force: Projected	Annual increase: Actual	Annual increase: Projected
1951	[1] 66,401			
1952	[1] 66,977		576	
1953	67,362		385	
1954	67,818		456	
1955	68,896	68,896	1,078	
1956	70,387	69,692	1,491	796
1957	70,746	70,681	359	989
1958	71,284	71,538	538	857
1959	71,946	72,505	662	967
1960		73,550		1,045
1961		74,752		1,202
1962		75,886		1,134
1963		77,181		1,295
1964		78,412		1,231
1965		79,872		1,460
1970		87,092		[2] 1,445
1975		94,775		[2] 1,537

[1] Based on revised population estimates.
[2] 5-year average.

Source: U.S. Department of Labor.

TABLE III.—*Duration of unemployment—Proportion of unemployed persons unemployed for 15 weeks or longer*

[Annual averages, 1951–59]

	Total unemployed [1]	Unemployed 15 weeks or more	Percent unemployed 15 weeks or more
	Thousands	*Thousands*	
1951	2,099	303	14.4
1952	1,931	232	12.0
1953	1,870	211	11.3
1954	3,578	812	22.7
1955	2,903	703	24.2
1956	2,822	533	18.9
1957	2,936	560	19.1
1958	4,681	1,452	31.0
1959	3,813	1,040	27.3

[1] New definitions.

Source: U.S. Department of Labor.

The CHAIRMAN. The discussion will be continued by Mr. George Brandow, of Pennsylvania State University, on the outlook for agriculture.

STATEMENT OF GEORGE E. BRANDOW, PENNSYLVANIA STATE UNIVERSITY

Mr. BRANDOW. Thank you, Senator Douglas.

In 1958, a combination of special circumstances raised net income of farm operators to the highest level in 6 years, although much of the rest of the economy was moderately depressed. Farm income fell in 1959, however, and in the last half of the year net income reached the lowest point since the long decline began in 1952.

Consideration of probable changes in production, prices, costs, and income leads to the conclusion that several of the most important elements in the farm situation in 1960 are likely to differ in only small degree from those of 1959.

The most important unknown factor in the 1960 outlook is the volume of production of the leading farm commodities. There is little reason to suppose that the upward trend in total farm output, which in the 1950's averaged 2¼ percent per year, is slowing down, but weather and turning points in livestock cycles could cause significant variations from trend in 1960.

The recordbreaking feed grain crop of 1959—especially the corn crop—was in part due to favorable weather. Normal weather output in 1960 would be smaller but would still exceed domestic and foreign utilization in commercial channels. Fall seedings of wheat and the present condition of the crop suggest that production this coming summer will be almost the same as in 1959. The national acreage allotment for cotton will be the same in 1960 as in 1959, but more growers may elect the choice B option under which they can increase acreage. With normal weather, the 1960 cotton crop may slightly exceed production in 1959.

Beef cattle numbers on farms as well along in the expansion phase of their rather well-defined cycle. Marketings of cattle probably will rise by 5 or 6 percent in 1960, and the increase could be considerably larger if drought in the range States caused liquidation of herds.

Hog marketings will remain large during most of the first half of the year but in the second half will reflect a smaller spring pig crop, now expected to be 11 percent below last year's.

Dairy production is likely to rise slightly in 1960. Large poultry and egg production severely depressed markets last spring; this year, egg production may decline a little and broiler production may increase by a smaller amount than in recent years.

The index of total farm output, which jumped sharply in 1958 and held the gain in 1959, will stay at about the same high level in 1960 if the weather is average.

High incomes of consumers are sustaining a strong domestic demand for most farm products, but moderate changes in incomes at current high levels have little effect on the demand for most foods. Per capita consumption of total food in 1960 will be very nearly the same as in 1959. Cotton consumption is expected to increase. Actual tobacco consumption in 1960 will be about the same as in 1959, although cigarette sales probably will rise.

Commercial export demand for farm products looks as good in 1960 as in 1959. Dollar exports of wheat and tobacco may be down slightly, but cotton exports should be well above the low level of the 1958 crop year, soybean exports are expected to rise, and exports of feed grains should equal the large volume of 1959. The dollar value of all exports of farm products, including exports under Government programs, may rise by 5 or 10 percent in 1960.

Support prices for wheat and feed grains will be only slightly lower for this year's crops than for last year's. If the 1960 corn crop is smaller, market prices may not drop so far below supports at harvest-time as happened last fall. Support prices for cotton will be 5 percentage points of parity lower this year than in 1959. Unless the weather is especially poor, production of all of these crops will be large enough to make support prices the principal determinants of market prices.

Cattle prices are likely to average lower this year than last. Hog prices will be below last year's during most of the first 6 months; late next fall, however, hog prices may be one-fourth or more above the low levels reached in late 1959. Prices of dairy products are expected to improve slightly in 1960, but prices of poultry products may average out about the same as in 1959.

Little change in the average level of retail food prices is expected in 1960. The spread between farm and retail prices of foods almost surely will widen again, and farm prices of food products as a whole probably will be a little lower in 1960 than in 1959.

The volume of production supplies purchased by farmers from other sectors of the economy probably will advance in 1960, and, on balance, prices paid for them may rise slightly. Higher wage rates will at least offset a further decline in employment of hired labor. Real estate taxes will continue to rise, and high interest rates will be paid on a somewhat larger volume of debt. A little more feed and livestock will be purchased at slightly lower prices. Total production costs are likely to advance again in 1960.

Total cash receipts from marketings of farm products in 1960 probably will be slightly lower than in 1959 if average growing weather prevails over most of the country. Rising production costs

51708—60——4

will also reduce net income. Total net income of farm operators may be from 5 to 10 percent lower in 1960 than in 1959.

If past relationships continue to hold, high employment in industry will result in a further reduction in the number of farmers in 1960 and an increase in income obtained from nonfarm sources by those who remain on farms. These changes will apply mostly to farms that are much too small for economical family operation. Though per farm income from all sources may hold its own or even increase in 1960, the prospect of a small decline in total net farm income is more representative of the situation in which commercial farmers generally will find themselves.

Farm debts amount to only about 12 percent of the value of farm assets. The strong, sustained advance in farm real estate values that has contributed so much to this favorable statistic in the past may now be leveling off. A small rise in farmers' indebtedness is likely in the coming year. Net investment in farm plant and equipment in 1960 probably will be well below the high levels of 6 or more years ago.

The Government will acquire substantial amounts of wheat and feed grains, and probably some cotton, under the price support programs in 1960 if the weather is average. Disposal programs, especially Public Law 480, will move much of the acquired surplus out of stock, but the total investment of the Commodity Credit Corporation in loans and inventories is likely to show a net increase during calendar 1960.

The CHAIRMAN. Thank you very much.

The final discussion is by Mr. Roy Reierson, of Bankers Trust Co., on the outlook for the credit markets.

I understand you have some slides, Mr. Reierson.

STATEMENT OF ROY L. REIERSON, VICE PRESIDENT AND CHIEF ECONOMIST, BANKERS TRUST CO.

Mr. REIERSON. Yes, sir. Mr. Chairman, a business associate of mine has a motto which reads: "The more I don't talk, the less I am worse off." Perhaps after this meeting I shall ask him to share his motto with me.

I have a written statement, Mr. Chairman, that I would like to submit for the record. The initial portion of this statement consists of a summary of the conclusions set forth in the longer document.

With your permission, Mr. Chairman, I should like to project some slides, and, in my oral statement, make some comments on charts.

The essential economic assumptions that underlie my statements as to the prospects for the credit markets this year are set forth on pages 2 and 3 of the longer document and are in substantial agreement with the points of view expressed earlier by other members of this panel.

In brife, I am assuming that 1960 will be a good business year, with output continuing in an upward direction throughout the year, with gross national product totaling somewhere between $510 and $520 billion for the year.

Of special pertinence to an appraisal of the credit outlook are projections of a $7 billion accumulation of business inventories, a $5 billion increase in business investment outlays, retail sales of some 7 million passenger cars, 1,200,000 privately financed housing starts, a

continued upward trend in prices, and an adverse balance of payments of some $3 billion.

I believe these assumptions will not minimize any pressures in the credit market that may reasonably be expected in 1960.

The first chart shows estimates of the expansion of credit by years from 1954 through 1959. Long-term credit is the blue line. The short-term credit includes consumer credit, bank loans except real estate and consumer loans, and miscellaneous other short-term instruments. The green line, the U.S. Government and agency debt, excludes securities held by the Government investment accounts.

The amounts plotted in each year are increases during the year in the totals outstanding.

The first observation I should like to make is that total credit expansion reached a new record in 1959 in excess of $61 billion, our current estimate. The credit expansion last year was about one-third larger than in 1958. It was this sharp increase in the credit expansion that was responsible for the pressures that developed in the credit markets and for the increase in interest rates in 1959.

The long-term credit increase year by year shows substantial stability and a generally rising trend. The increase in 1959 was reasonably small, only about one and a half billion, or about 5 percent over the increase in 1958.

The components of this long-term credit are shown in one of the charts in the longer document, but in the interest of saving time I shall not project it here.

Last year, outstanding real estate mortgage debt, which is included in this long-term credit, expanded by a record $19¼ billion. This represented 60 percent of the total increase in long-term credit in 1959.

The increase in corporate securities last year was some 20 percent smaller, and the rise in tax-exempt debt of State and local governments was about 5 percent lower than in 1958; while the increase in outstanding mortgage debt was about 25 percent larger in 1959 than in 1958. The increase in mortgage debt in 1959 was about 20 percent larger than it was in the previous record year of 1955.

For 1960, we are projecting for long-term credit an expansion only slightly smaller than in 1959. The increase in tax-exempt debt is expected to be about the same as last year. Corporate securities are expected to show a larger rise than in 1959, and the increase in mortgage debt is put at a somewhat lower figure of about $17½ billion. This would represent an increase in mortgage debt about 9 percent under the record expansion in 1959, but it still projects the second largest yearly increase in mortgage debt on record, and mortgage debt as projected for 1955 would still account for 55 percent of the projected increase in total long-term debt.

Let me turn now to the changes in outstanding short-term credit. These changes are obviously more volatile, in response to changes in the economy. In 1959, short-term credit increased by close to $19 billion.

The CHAIRMAN. Mr. Reierson, may I ask if this includes short-term governments?

Mr. REIERSON. No, sir; this is exclusive of the Government debt.

The CHAIRMAN. Thank you.

Mr. REIERSON. The biggest contributors to the sharp rise in short-term credit in 1959 were consumer credit and bank loans. For 1960, we are projecting an increase in short-term credit about 10 percent lower than last year. We expect consumer credit to rise about as much this year as last, but we have reduced the expansion in bank loans somewhat for 1960.

Finally, the green line, U.S. Government and agency debt, includes both long- and short-term debt outstanding with the public. In 1959, outstanding Government debt and agency debt showed a record peacetime increase of almost $11 billion. This is in sharp contrast with 1955, which was another year of business expansion, when the increase in outstanding Government and agency debt was only $1½ billion.

That the large Treasury credit requirements in 1959 were a major factor in the upward pressure on interest rates is indicated by the fact that Treasury credit requirements comprised almost one-fifth of the total credit expansion in 1959. The comparable percentage back in the earlier period, 1955, was about 3 percent.

For 1960, we are projecting a dramatic improvement in the position of the Treasury. If the Treasury's budget position improves in line with our assumptions—and this requires tight control over expenditures and no tax cuts—we expect Treasury debt to show no appreciable net change during 1960. It could possibly show a very small net decline during the year.

So, in other words, we are projecting total credit expansion in 1960 sharply lower than in 1959. The total we are currently projecting for this year is not too much different from the total that was experienced in 1958, but, as I have just noted, the great bulk, about 80 percent of the projected decline, is due to the anticipated improvement in the Treasury's position.

I should now like to turn to the other half of this equation—namely, a chart which shows how this credit expansion was financed.

We show three lines on this chart. The first line shows savings institutions, which include life insurance companies, savings banks, savings and loan associations, pension funds, retirement funds, and the like.

The "other" group includes a miscellaneous group consisting of business concerns, foreign holders, individuals, and so forth. The commercial banking system, as defined here, includes the Federal Reserve banks.

The funds provided by savings institutions show a steady secular rise throughout the period with a minimum of cyclical fluctuations or disturbances. The detail underlying this aggregate are again set forth in one of the charts attached to the longer document, which I shall not discuss in detail.

Over the period shown by this chart (1954–59), the savings and loan associations show an outstanding record of dynamic growth. Pensions and retirement funds have also been growing quite vigorously, but the growth of life insurance companies has been less dynamic. Sales of mutual fund shares have increased sharply in recent years.

In 1959, these savings institutions provided about $24 billion of funds, or a little under 40 percent of the total funds required for credit expansion. For 1960, these institutions are expected to provide about as large a volume of funds as they did last year.

Let me turn now to a discussion of the "other" category. The absorption of credit instruments by this group of holders shows substantial year to year fluctuations. Individuals and other holders are typically attracted to the credit markets in a big way in periods of active business and rising interest rates. With the easing of interest rates, however, as in 1958, their acquisition of credit obligations dropped to nominal proportions.

In 1959, we had a terrific increase in the amount of credit provided by these "other" holders. The total is about $32 billion, a threefold increase over the amount provided in 1958.

Business corporations, foreign investors, and miscellaneous investors, all stepped up their acquisitions sharply last year. In total, this group absorbed more than one-half of the total net increase in outstanding credit instruments in 1959.

For 1960, we are projecting smaller acquisitions by this group. We think business corporations will probably reduce their holdings of Treasury obligations this year, and foreign investors are not expected to make the large additions to their holdings that they did in 1959.

The commercial banking system contribution to the meeting of the credit needs of the economy is measured by the sum of loans and investments outstanding. This has been contracyclical in its behavior, in response to credit policy. The data show a cyclical rise in years of recessions such as 1954 and 1958, when reserves are provided liberally, in accordance with the dictates of a contracyclical credit policy.

The other half of a contracyclical flexible credit policy, of course, is to exercise restraint in the provision of bank reserves in a period of business expansion. Consequently, in 1959, the net amount of credit made available to the economy by the commercial banking system dropped sharply, from about $17 billion in 1958 down to about $5½ billion in 1959.

What happened in 1959—this is shown also in one of the detailed charts—is that the commercial banks added significantly to the holdings of loans, but at the same time made large sales of Government obligations, so that the net impact on total loans and investments was of this order of magnitude.

Now, for 1960, we are projecting the credit expansion of the commercial banking system on the assumption that sufficient reserves will be provided to permit an increase of 2 to 3 percent in total bank deposits. This would involve an increase in total bank loans and investments slightly larger in 1960 than in 1959.

Let me now turn, if I may, to another chart. The top line shows industrial production and the amount of credit supplied by commercial banks each year. The latter shows a very large increase in 1958, a year of recession, and a much smaller increase in 1959, a year of business expansion.

This pattern is perfectly consistent with the objectives of a contracyclical flexible credit policy.

In years of business expansion, such as in 1956 and 1957 and in 1959, the amount of credit provided by the banking system drops from the amount provided in preceding periods of recession, as shown in the lower panel of the chart, the percentage of the total credit provided by the commercial banks displays the same contracyclical behavior. That is, the percentage of credit provided by the com-

mercial banks rises sharply in periods of business recession, in accordance with the principles of flexible credit policy, and declines in periods of business expansion, again consistent with contracyclical credit policy.

The next chart is pertinent because of the question that has been raised as to whether the banks are fully loaned. This chart shows the percentage of loans to total assets for three classes of banks. The central Reserve city banks, the banks in New York and Chicago, are the red. The Reserve city banks, the banks in 90-some-odd cities, are the orange. The others are what we call country banks; the smaller banks are shown in the green.

In recent years, in fact, ever since about 1943 or 1944, the percentage of loans to total assets has been rising rather steadily.

I would like to make two observations. The first is that even after that increase, the percentage of loans to assets is still significantly lower today than it was back in the 1920's, when the commercial banking system was actively engaged in financing industry and commerce.

My second observation—and this is of special pertinence—is that the percentage of loans to deposits in the country banks, the smaller banks, is significantly lower than it is in the central Reserve and Reserve city banks, whereas back in the 1920's the percentage was much higher in the country banks.

In other words, I think it is fair to conclude that country banks have more unutilized lending power than do the city banks; and this certainly suggests to me that credit is more readily available to the customers of the country banks—namely, to smaller businesses and individuals—than it is to the customers of the big city banks.

Another question that is pertinent, I think, in looking at the background of recent credit developments, is whether bank credit has kept pace with the growth of the economy.

This chart shows, on the top panel, two plottings of gross national product, current dollar gross national product, and real gross national product (measured in 1954 dollars) in the red. The third line shows total bank loans and investment. There is a general similarity in movement over the period, that is, increases in gross national output and in bank credit. This period was selected to include the period since the Treasury-Federal Reserve accord.

The lower panel shows bank credit expressed as a percentage of dollar gross national product and of gross national product measured in real terms.

The conclusions of this chart I think are fairly interesting. The annual increase in bank loans and investments has displayed cyclical fluctuations in response to flexible credit policy. The percentage of loans to gross national product rises in recession years; it declines in years of business expansion.

However, I would point out, Mr. Chairman, that the percentage of bank loans and investments to current dollar gross national product is higher today than it was when the Treasury-Federal Reserve accord was formulated. And I would further point out that bank loans and investments are a much higher percentage of real national product today than they have been at any time during this period.

In other words, there has been sufficient bank credit available not only to finance real growth, much more than required to finance real

growth—and this raises the question as to whether some of this bank credit has not gone into financing price increases.

This chart shows another factor that is of some pertinence in the discussion of the outlook for credit policy. This chart shows the percentage relationship between certain concepts of money supply and liquid assets and current dollar gross national product. The bottom line shows the restricted definition of money supply—that is, demand deposits and currency outside the banks—as a percentage of gross national product. That percentage has been going down rather consistently throughout the postwar period. The decline since 1951, however, has slowed down significantly.

Now, I submit that in recent years, several things have happened which have reduced the economic significance of this restrictive definition of money supply. Individuals and business concerns increasingly are holding other types of near cash assets which perform substantially the same economic functions as are performed by demand deposits and currency.

For that reason, we have shown three additional curves on this chart, picking up various classes of other liquid assets.

The time deposits of commercial banks have increased much faster than have demand deposits. Consequently, if we include time deposits of commercial banks in money supply, the rate of decline in this percentage dwindles. And there has not been any decline since about 1957.

If we include deposits of mutual savings banks and savings and loan associations, together with time deposits of commercial banks and demand deposits adjusted and currency, we then get liquid assets I. The growth has kept pace with the current dollar gross national product ever since about 1951. In other words, there has been no squeeze on liquidity. And if we include Treasury obligations of 1-year maturity or less held outside the banks, the percentage has been rising, as you can see, rather steadily and consistently ever since 1951.

This approach has been subjected to some criticism, on the ground that it implies that we should have enough money and liquid assets to validate any amount of inflation that may develop.

In order to take another look at this picture, we have related these same concepts of money supply and liquid assets to real gross national product, measured in terms of 1954 dollars. The conclusions are quite evident. There has been practically no reduction in money supply relative to real gross national product, even using the very restricted definition of money supply.

If we include time deposits of commercial banks, the percentage has been rising since about 1951. If we include deposits of mutual savings banks and shares of savings and loan associations, the rise is quite striking, and if we include 1 year of Treasury obligations held outside the banks, the percentage of liquid assets to real gross national product is significantly higher now than it has been at any time since the end of the war.

This, I think, entitles one to make an observation: That is, if real economic growth in this country has not been faster, the reason is not to be found in a shortage of money or in liquid assets. The real question is whether fiscal debt management and credit policies com-

bined have not been too liberal and may not have encouraged price increases by providing more liquid assets than would be required by the growth in the economy.

The next chart shows what happened to interest rates in 1959. This chart shows municipal bond yields, yields on long-term Treasury bonds, yields on 3- to 5-year Treasury issues, yields on Treasury bills (new issues), and yields on corporate double-A bonds.

It is clear that all classes of interest rates increased in 1959 and at the end of the year were at levels significantly higher than at the beginning of the year. It is also clear that the rise was most pronounced in the short and the intermediate areas—in the Treasury bill yields and in the yields on 3- to 5-year Treasury obligations—and that the increase in bond yields (corporate bonds, Treasury bonds, or municipal bonds) was much more modest.

Now, part of this sharper increase in short- and medium-term rates is to be expected in a period of business expansion such as 1959. These rates tend to be more sensitive to fluctuations in business and credit conditions. But the upward pressure was reinforced in 1959 by the terrifically large increase in outstanding Treasury debt, almost 20 percent of the total increase in credit being represented by the rise in Treasury debt, and by the concentration, because of the interest rate ceiling, of that financing in issues with a maturity of less than 5 years.

The effect was to increase the volume of short-term debt instruments outstanding, and to put short- and medium-term yields under substantial upward pressure.

This next chart intrigues me, Mr. Chairman. We prepared it for this meeting. This chart shows the relationship between the amount of 1-year outstanding Treasury debt and the Treasury bill yield.

We find that Treasury bill yields rose at the same time there was an increase in the volume of outstanding obligations. This, I submit, is more than accidental.

We have had two sharp increases in short-term interest rates since the business recovery began. The first occurred in the third quarter of 1958. And you will recall that at that time there was a widespread, and fairly sudden, recognition of the fact that the business recovery was real. There was a more widespread appreciation of the great unbalance that was impending in the Treasury accounts. There was the expectation of a large volume of Treasury financing forthcoming. And there was a resurgence, whether justified or not, of inflation psychology. We had, therefore, a very sharp anticipatory market rise in Treasury bill yields at this point.

In the second quarter of 1959, the volume of 1-year Treasury debt outstanding began to rise very sharply. And with it there came a second sharp increase in the Treasury bill yield. I would point out that from the second quarter of 1959 to the end of the year, there was an increase of $12 to $13 billion in the volume of outstanding 1-year Treasury obligations.

So I submit, it was the large increase in the volume of outstanding obligations that was responsible for the very sharp rise in short-term interest rates.

The next chart shows what happened in 1958–59 to the Treasury bill yield, to the discount rate, and to net borrowed reserves. In 1958,

we had the anticipatory rise in Treasury bill yields to which I have just referred. The second big rise in Treasury bill yields occurred in the latter half of 1959.

I would make a series of observations. The first is that the discount rate generally lagged behind the market rates during this period. From mid-1958 through February 1959, the market yields moved ahead of and were higher than the discount rate. In the next few months they moved together; then for a few months, the discount rate moved ahead of the market rates. In the last few months of the year, however, the market rates rise sharply with no change in the discount rate.

It is not valid to say, on the record, that the discount rate has generally led the Treasury bill rate. The facts are quite the reverse.

May I also point out, Mr. Chairman, that this sharp increase in the Treasury bill yield in the latter part of 1959 came at a time when net borrowed reserves were declining. In other words, the Federal Reserve was not subjecting the credit markets to increasing pressure during this period, despite which Treasury bill yields increased very sharply.

Mr. Chairman, I have two or three more charts. Should I continue, or have I exhausted my credit?

The CHAIRMAN. We certainly do not want to shut you off. On the other hand, I think the other witnesses took 10 minutes apiece, and you have taken approximately a half hour. But we want to be very generous to you. So I would say go ahead.

Mr. REIERSON. Well, I have perhaps three more charts that bear on the international situation.

Representative PATMAN. May I ask the chairman a question?

Mr. Chairman, in view of the fact that the members of the panel have taken up so much time—and I have enjoyed every minute of it; it has been worthwhile—and we are not going to have an afternoon session this afternoon, because of the illness of Secretary Anderson, would it be in order to ask that we have an afternoon session to interrogate the members of the panel?

The CHAIRMAN. May I ask if the members of the panel could come this afternoon? Or have you made other plans? How many could come this afternoon?

All except Mr. Gainsbrugh.

Well, I would think so, and that we could set 2:30 as the time.

Representative PATMAN. Yes, sir. That would be satisfactory.

The CHAIRMAN. Go ahead, Mr. Reierson.

Mr. REIERSON. I shall omit several charts I wished to show. I have slides for all of these, and if this afternoon you want to discuss any of them, I shall be glad to do it.

I do think the last there charts are of particular interest. They deal with the international position, a subject that is of some currency.

The significance of the balance of payments position of the United States is being brought home in the credit markets and in the entire economy. The deficit in our balance of payments has increased. The dollar has suffered several sinking spells. Gold has been withdrawn, and short-term indebtedness to foreigners has climbed rapidly.

This chart shows what has been happening to the monetary gold reserves of the United States and the rest of the world, excluding the

Communist bloc, from 1949 to date. From 1949 to 1957, there was a little evidence of a decline in the U.S. holdings, but the loss was not very large. The rest of the world, however, was able to increase its holdings rather significantly during this period.

Of greatest interest, is what happened in 1958 and 1959. During these 2 years we lost about $3½ billion of monetary gold, or about 15 percent of our gold stock. The rest of the world added large amounts to its moneary gold stock during the same period.

In the second quarter of 1959, the rest of the world's gold stock finally exceeded ours.

Our concern obviously is not with the level of our gold holdings. We still have almost 50 percent of the monetary gold stock of the free world. But this loss of gold has its impact, as you gentleman know, upon our "free" reserves: the amount of gold available after providing for the reserve requirements of the Federal Reserve bank.

The next chart shows an interesting interrelationship between gold movements and the Treasury bill yield. What happened, of course, was that in the first and second quarters of 1958 the United States loss in monetary gold increased very sharply. In the second quarter of 1958 we lost about $1,100 million of gold in one quarter. Interestingly enough, this was the period when we were following an aggressive easy money credit policy, as shown by the decline in the Treasury bill yield down to 1 percent or a little under in this period.

Since the second quarter of 1958, we have continued to lose gold, but at a much more modest rate. A contributing factor, I think, unquestionably, is the change in the interest rate situation—the fact that our Treasury and other short-term open market rates, are now significantly higher than they were back in 1958. This provides more incentive for foreigners to hold funds in short-term investments in the United States.

Let me add that I do not think this decline in the gold outflow can be attributed entirely to the behavior of short-term money rates. There was in improvement at least in the latter part of 1959, as I sense it, in the appraisal of the position of the dollar on the part of foreigners, particularly those in Europe. There was some easing of their scepticism as to the dollar. They saw the improvement in our budget prospects. They were heartened by the failure of the large spending plans to materialize. They were cognizant of the efforts of the Federal Reserve to continue to apply a flexible credit policy. And with the inducement provided by the yields prevailing in the American money markets, they therefore reduced their withdrawals of gold and increased their holdings of short-term dollar assets.

However, we continued to run an adverse balance of payments during this period. In fact, the adverse balance of payments in 1959 is greater than in 1958—about $3.4 billion in 1958 and close to $4 billion last year.

Since the gold outflow declined, beginning about the middle of 1958, but since the adverse balance of payments continued, the result was a very sharp increase in foreign holdings of short-term dollar assets. These have now increased at the end of last year to approximately $19½ billion, an increase during the year of something in the order of magnitude of $3 or $3¼ billion.

Obviously, as long as we continue to run a large deficit in our balance of payments—and I have said earlier that I anticipated a further deficit this year, possibly of as much as $3 billion—we face a choice between two alternatives. We shall either continue to lose gold, or we shall continue to add to our short-term liabilities to foreigners.

The sharp increase in these liabilities obviously poses uncertainties in our economic and financial situation. It subjects us to adverse developments if for any reason the holders of any large amounts of these short-term balances decide that they wish to withdraw their funds from this market.

So I suggest that the only real cure of our problem is some improvement, some redressment, in what I regard as a very difficult and serious continuing balance of payments situation.

My apologies to you, Mr. Chairman, and to the members of the committee, for taking so long. And my apologies to the other members of the panel.

The CHAIRMAN. Thank you very much. Your prepared statement will be included in the record.

(The prepared statement of Roy L. Reierson is as follows:)

OUTLOOK FOR THE CREDIT MARKETS

STATEMENT SUBMITTED BY ROY L. REIERSON, VICE PRESIDENT AND CHIEF ECONOMIST, BANKERS TRUST CO., NEW YORK

SUMMARY AND CONCLUSIONS

Credit conditions and interest rate levels are the net results of a great and complex variety of forces which are at work in the marketplace at all times. Obviously, the state and direction of the economy, and the expectations that prevail for the future, are of decisive influence. The actions of the Federal Reserve and the Treasury are strategic, and economic developments abroad have also come to be of increased importance to our credit markets in recent years.

This, however, works both ways. What happens in the credit markets and in business affects the budget and debt operations of the Treasury, the policy decisions of the Federal Reserve, the attitudes of borrowers and lenders, and the flow of savings and investments. These interactions always make an appraisal of the credit picture difficult and involved, but they cannot be brushed aside if we are to attain some perspective on where we stand and where we are going.

Record credit expansion

With the economy setting a new peak, total credit outstanding registered a record peacetime increase of more than $60 billion last year, which was about one-third more than the increases in 1955 or 1958, the 2 previous years of especially rapid expansion in credit. Mortgage credit advanced by an unprecedented $19 billion, or nearly 20 percent ahead of the previous record set in 1955. Bank loans and consumer credit also increased sharply last year.

The pressures in the credit market in 1959 were greatly augmented by the $11 billion increase in the publicly held debt of the Federal Government and agencies. This was a greater rise than in any year except during World War II. Net Treasury borrowings accounted for almost one-fifth of the total credit expansion of 1959, reflecting our failure to achieve substantial Treasury surpluses in periods of expanding business, when private financing requirements are expanding. Thus, the competition of the Treasury crowded the market for private borrowers, materially adding to pressures.

Higher interest rates

The rise in interest rates last year was typical of a period of expanding economic activity. All classes of interest rates moved higher, but the sharpest advance was in the short- and medium-term sectors of the market. This reflected the combination of large cash borrowings by the Treasury and the fact that the

Congress, in failing to lift the 4¼-percent interest rate ceiling on new issues of Government bonds, in effect compelled the Treasury to do almost all its financing at the shorter end of the credit markets. The sharp rise in these rates doubtless added to the upward pressures on bond yields.

Nevertheless, interest rates are not abnormally high; in fact, long-term interest rates are lower than in the major countries of western Europe, and both long- and short-term rates are currently below levels typical for earlier periods of prosperous business prior to the great depression. In particular, yields on corporate bonds, and on bonds of State and local governments, are less than during the mid-1920's.

Yields on Treasury obligations, however, are significantly higher than in these earlier years, and the reasons for this are twofold: (1) In the 1920's, the Treasury was consistently operating at a budget surplus, the retirement of Government debt helped release funds to private borrowers, and interest rates in general, consequently, followed a declining trend; and (2) the amount of Government-insured and guaranteed obligations, which involve a pledge of the credit of the United States, has been rising sharply and steadily in recent years, so that the Treasury has been forced to compete against itself in the credit markets under very adverse conditions, the more so as these insured and guaranteed obligations generally carry interest rates significantly higher than the statutory ceiling on direct Treasury bonds.

Significantly, interest rates over long periods of time have tended to move with the price level; inflation adds to the pressures which cause interest rates to rise. If these upward pressures or interest rates are to be moderated, we need to achieve stability in the price level. Also, as the lesson of 1959 has so vividly demonstrated, we need to achieve sizeable surpluses in the Federal budget during periods of rising activity in order to avoid the additional pressures from the side of Treasury financing. Finally, a tax system and general public policies designed to give more encouragement to saving would also work toward restraining interest rates.

Adequacy of credit

Further expansion of business activity in 1960 is not likely to be prevented by a shortage of credit. The flow of funds accruing to the savings institutions will be about as large this year as in 1959. There is still considerable lending power within the commercial banking system, and another significant increase in bank loans seems a reasonable prospect for this year. It is assumed that sufficient reserves will be made available to the banking system to permit an increase of 2 to 3 percent in aggregate bank deposits.

Thus, there is little danger that the economy will be starved for credit to finance a further growth in real output in 1960. The degree of tightness that prevails in the credit markets today is not excessive; it is typical of periods of expanding business and provides an important safeguard against the sort of credit excesses that have in the past culminated in spirals of credit liquidation. As a business expansion proceeds, the risk increases that credit will be used for speculative purposes, for excessive accumulation of business inventories, or to support capital investment at rates that cannot be sustained. Thus, too liberal expansion of credit in a period of high level business activity is very likely to widen the amplitude of cyclical fluctuations in business activity and employment. This would work directly contrary to the goal of flexible credit policy of moderating business recessions and promoting economic growth.

Credit policy: Moderating business fluctuations

Since 1951, the Federal Reserve has been following a flexible credit policy. One basic objective of this policy is to moderate cyclical swings in business activity; the other is to facilitate economic growth.

A cardinal feature of the countercyclical aspect of credit policy is that bank reserves are provided liberally in a period of business recession and with greater restraint during a business expansion or when the economy is operating at a high level of activity. The Federal Reserve supplied huge reserves in the recession of 1957–58 and, in the business expansion that began in the second quarter of 1958, has been following the other half of countercyclical credit policy by providing reserves less liberally, more cautiously, and with greater restraint. Nevertheless, the volume of commercial bank credit in 1959 averaged 6 percent higher than in 1958, and a further but more modest increase in bank deposits and assets seems in prospect for 1960.

Credit policy: Facilitating economic growth

Likewise, despite repeated criticism, the record shows that credit policy has not retarded the growth of the economy. On the contrary, since the adoption of a flexible credit policy after the Treasury-Federal Reserve accord in 1951, the total of loans and investments of the commercial banks (which reflects the amount of reserves made available to the banking system) has increased fully as fast as the gross national product measured in current dollars and faster than the real gross national product. Thus, credit policy has not reduced the availability of bank credit.

The point is sometimes made that the volume of demand deposits and currency in recent years has not kept pace with the rise of gross national product, measured in current dollars. However, individuals and businesses have for some time been shifting funds from checking accounts into other liquid but interest-bearing assets (time deposits, saving accounts, and short-term Treasury obligations) and using them, in part at least, as substitutes for demand deposits. If this is taken into account, it is evident that the economy is more liquid now than it has been at any time in the 1950's.

Furthermore, liquid asset holdings in the economy have increased much faster than has gross national product measured in real terms, and this rise in liquidity has contributed to the upward trend of prices. The real question is not whether the flexible credit policy of the Federal Reserve has been unduly restrictive, but whether, on the contrary, credit, fiscal, and debt management policies together over the years have tended to be too liberal and, by providing more liquidity than the economy needed for real growth, have helped to encourage inflation.

International aspects

The large deficits in the U.S. balance of payments in 1958 and 1959 have resulted in the loss of some $3½ billion of monetary gold and the accumulation, by foreigners, of record holdings of short-term dollar assets now totaling close to $19½ billion. With the substantial restoration of currency convertibility on an international scale, the movement of funds to and from the other countries in response to changes in interest rates and other developments has assumed renewed importance. Business activity in Europe, after a period of slack, is once again on the rise and some foreign interest rates have already firmed. This trend raises the possibility of a larger gold outflow from the United States, unless interest rates here at home continue to provide an incentive to foreigners to leave their funds in the American market.

Moreover, the U.S. dollar is a key currency, and our domestic policies, including credit, fiscal, and debt management policies, must be such as to maintain confidence in the dollar on the part of foreign holders of short-term dollar balances. A widespread loss in world confidence in the dollar would mean an international financial crisis from which the United States could not expect to be immune. It would be a serious blow to the political as well as the economic strength of the entire free world.

The outlook for 1960

Credit expansion in the year ahead will, in the aggregate, be significantly less than the $60-odd billion increase of 1959. This presupposes, however, that the Treasury achieves the anticipated surplus which means that Government spending is not increased and that taxes are not cut. In that event, the Federal Government and agency debt may well show a small decline in 1960, in contrast to the record peacetime rise last year.

Private credit expansion, however, will probably be about as large as in 1959 if present forecasts of a good business year materialize. State and local government debt and consumer credit are expected to increase by broadly the same amounts as last year. Mortgage debt and loans of commercial banks are expected to show smaller increases than last year, but net new issues of corporate securities are expected to rise.

Moreover, despite the prospective shift in the Treasury's position from a huge cash deficit to a small surplus this year, the problems of debt management continue formidable. Refinancing requirements are heavy, and the Treasury will still need to make repeated large cash offerings to cover net redemptions of savings bonds, attrition on maturing issues, and the seasonal deficit in the second half of the year.

The course of interest rates in 1960 obviously depends upon the vigor of the business expansion. Current business prospects suggest continued firm or possibly even moderately higher interest rates in the course of 1960, but much of these expectations may already have been discounted in the marketplace. An easing of credit conditions and interest rates, on the other hand, is not likely until there is evidence that business is topping off and that a cyclical business decline is in prospect.

Credit policy will have an important bearing upon the business trend. Under current conditions, a policy of credit restraint would help to extend the period of good business. By minimizing the hazards of an inflationary boom and of too rapid an expansion of inventories, business investment or consumer buying, we shall increase the likelihood of keeping business on an even keel not only in 1960 but also in 1961. This would help reduce the extent and duration of a cyclical downswing at a future date.

In conclusion, it is pertinent to consider that for many years public policies have operated in the direction of higher interest rates. Borrowing has been facilitated, saving has been discouraged. Treasury deficits have been large, and have had to be financed at inopportune times. There is an understandable temptation to seek to cope with the cumulative consequences of these forces by requiring that the Federal Reserve pump large reserves into the banking system at times when business is active and demands for funds are high. However, this would mean either encouraging credit expansion as actively in a boom as in a recession—with all its inflationary consequences—or refraining from supplying reserves in a recession in order to moderate the funds furnished during a boom.

Neither alternative makes sense. The abuse of central bank credit can have serious consequences today as did the abuses of coinage and currency in earlier periods of history. Whether a nation clips its coins, issues large amounts of fiat paper money, or forces its central bank to feed the banking system with excessive reserves, the ultimate consequences are the same.

THE ECONOMIC BACKGROUND

The credit markets have been operating in a generally expanding economic environment since the spring of 1958, and signs portend a further advance in business activity in 1960. Although capacity and resources are amply available, the trend of commodity prices, except for farm and food products, continues upward. At the same time, the American economy has become more sensitive to the pressures posed by keener competition in world markets and by large deficits in the U.S. balance of international payments.

Strategic factors in 1959

The output of goods and services increased sharply in 1959. Despite the protracted steel strike, gross national product, measured in current dollars, rose by about 8½ percent, and industrial production averaged some 13 percent above the previous year. This advance in business activity was broadly based and was accompanied by an exceptionally large expansion of credit.

Among the trends in the economy which help to explain the record credit demands and other developments in the credit markets in 1959 were the following:

Business sales were 11 percent higher than in 1958 and business inventories increased by some $4 billion.

Business spending on plant and equipment advanced by more than $2 billion, or about 7 percent.

Automobile sales expanded by about 28 percent to 5½ million units.

Privately financed housing starts set a new record at 1,341,000 units, an increase of 17½ percent over 1958.

Total construction outlays reached $54 billion, which is more than 10 percent above 1958.

Rising prices contributed to larger credit requirements. The consumer price index increased by about 1½ percent and the index of wholesale prices of industrial products advanced by almost 1¾ percent.

The Treasury ran a cash deficit of more than $7 billion in the calendar year 1959. The outstanding marketable debt of the Treasury and Federal agencies climbed by almost $15 billion, a record increase for a peacetime year.

The deficit in the U.S. balance of international payments rose from $3.4 billion in 1958 to about $3.7 billion in 1959, not including the subscription of $1,375 million to the International Monetary Fund.

Net sales of monetary gold declined from $2.3 billion in 1958 to about $1.1 billion last year, but U.S. short-term liabilities to foreigners and international institutions soared from $16.2 billion at the end of 1958 to an estimated $19.5 billion at the close of last year.

The outlook for 1960

The projections of credit expansion here presented assume a further rise in economic activity in 1960. Gross national product is expected to be in the neighborhood of $510 to $520 billion, for an increase, in current dollars, of around 7½ percent or so from 1959, with output continuing in an upward direction throughout the year. The assumptions here expressed on the economic outlook are deliberately optimistic in order to avoid minimizing the pressures that may arise in the credit area.

Some of the economic developments likely to affect credit conditions in 1960 are projected as follows:

Business inventories may expand by some $7 billion in the year ahead as the result of replenishment of depleted stocks and further accumulation.

Business spending on plant and equipment is likely to rise throughout the year, with outlays in 1960 estimated as one-sixth, or more than $5 billion, larger than last year.

Retail sales of automobiles, it is assured, will approach 7 million units.

Private housing starts are projected at 1.2 million, with total construction expenditures not materially different from 1959.

Living costs and prices of industrial products are expected to advance at about the same rate as in 1959.

The outstanding marketable debt of the Treasury and Federal agencies may not change much for 1960 as a whole, but seasonal borrowing and refunding operations will be substantial.

The balance of payments situation is likely to continue adverse, but the deficit may ease to around $3 billion, or perhaps even slightly less, in 1960.

It is impossible to estimate with any assurance how much of the deficit in the balance of payments will be settled in gold. However, if foreign confidence in the dollar does not deteriorate, the gold outflow in 1960 may be guessed at $1 billion and could even be smaller.

Implications for credit conditions

Translating these economic prospects into a considered outlook for the credit markets is assuredly a hazardous venture. Many pertinent financial statistics for the past year are not yet available, but possession of even the most complete data would not assure the accuracy of conclusions regarding the future. The climate in the credit markets, even more than in the areas of production and spending, is subject to frequent and sudden changes, since borrowers, lenders, and investors have alternatives which they may utilize in response to new conditions or expectations.

This does not mean that efforts to appraise prospective financing requirements and credit flows are necessarily in vain. What it does suggest is that, in assaying the future, perfecting statistical projections is less important than is recognizing the major forces likely to be at work, the probable direction of their movements, and their implications for the financial markets, for credit policy, and for the economy as a whole.

THE VOLUME OF CREDIT EXPANSION

The recent record of credit expansion is illustrated on chart 1, which shows the net change in credit outstanding for each year, beginning with 1954, for three major categories: (*a*) long-term, consisting of real estate mortgages, State and local government obligations, and corporate securities;[1] (*b*) short-term, including consumer credit, bank loans (except loans to real estate and consumers), and miscellaneous other short-term instruments; and (*c*) U.S. Government and agency debt, exclusive of securities held by the Government investment accounts.

It is apparent from the chart that in 1959 the expansion of the economy, together with continued huge Treasury borrowings, led to a greater increase in the amount of credit outstanding than in any previous peacetime year. For

[1] Including foreign securities sold in the United States and net new issues of corporate stock.

1960 a repetition of last year's budget deficit is not in sight, but other credit requirements are unlikely to total appreciably less than in 1959.

Record increase in 1959

The expansion by an estimated $61½ billion in the total amount of credit outstanding in 1959 was one-third larger than the $46 billion increase of 1958. Moreover, each of the three categories of credit—long-term, short-term, and Government—individually expanded at a record rate, with short-term credit showing an especially strong upsurge compared with 1958.

In 1955, the last previous year of a vigorous economic advance, credit had also expanded at an unusually rapid pace. Last year, however, unlike in 1955, the upsurge in credit was boosted materially by the sharp increase in the Federal Government sector, as indicated in the following table, which compares the expansion of credit in the 2 years (in billions):

Type of credit	1955	1959	Change
Long-term	$25.7	$32.0	+$6.3
Short-term	17.1	18.7	+1.6
Government	1.4	10.8	+9.4
Total expansion	44.2	61.5	+17.3

The crucial element in 1959 was unquestionably the big rise in the Government sector, which constituted 18 percent of the total increase in credit last year, compared with only 3 percent of a much smaller total in 1955. This contributed importantly to the greater tightness in the credit market in 1959, the more so as the 4¼ percent interest rate ceiling on the issuance of Treasury bonds compelled the Treasury to do almost all of its financing in the short- and intermediate-term sectors of the market, where pressures were already heavy as the result of active borrowings from business and consumers. This illustrates forcefully and dramatically the consequences, for the credit markets and for interest rates, when the Treasury must finance a deficit at the same time that economic activity is on the rise and credit demands are strong.

Trends in 1960

Chart 1 includes some tentative projections for 1960. If the prospective improvement in the Treasury budget and debt position is achieved—and this implies tight control over expenditures and no tax cuts—total credit in 1960 may be expected to expand substantially less than in 1959, but still by an extremely large amount. In fact, excluding the Federal Government, credit expansion in 1960 could come close to last year's peak.

This prospect, which is supported by the outlook for a good automobile year and substantial inventory building by business, would be in contrast to the pattern in the former cyclical uptrend of the economy in 1954–57. Then, the banner year 1955 was followed by a considerably more temperate increase both in business activity and in credit requirements, partly because automobile sales declined quite markedly from 1955 to 1956. Today, the signs point to two consecutive years of vigorous growth in total output and in credit.

The long-term sector

Of the three major types of credit, as chart 1 shows, the long-term sector is the steadiest in its year-to-year movements. However, while total long-term credit tends to increase at a fairly even pace, its principal subdivisions often fluctuate quite widely from year to year. This is illustrated on chart 2.

Reflecting the boom in home building, mortgage debt in 1959 is estimated to have expanded by an unprecedented $19 billion, or over 25 percent more than in 1957 and almost 20 percent greater than in the previous peak year 1955. State and local governments, on the other hand, increased their debt by about the same amount as in 1958, and net new security issues by corporations were considerably less than in the previous year. This decline in new corporate financing in 1959 was attributable in part to the higher liquidity resulting from greatly improved profits at a time when the pace of spending on plant and equipment was still fairly sluggish; also, business relied more heavily on bank loans last year.

For the current year, it seems reasonable to project the expansion in total long-term credit at a level slightly lower than in 1959, as indicated on chart 2.

Corporate long-term financing is likely to be somewhat larger than last year, mainly because of the expected increase in spending on plant and equipment and because of higher working capital requirements. Net borrowings by State and local governments are expected again not to show any important change. The rise in mortgage debt, however, will probably be smaller in 1960 in the wake of the recent decline in housing starts.

Chart 2 illustrates also the flexibility of the investment markets in allocating available funds among the various outlets in response to changes in underlying economic conditions and credit demands. Since the flow of savings does not change greatly from year to year, this flexibility is essential; without it, periods of expanding business and rising credit demands would lead to extreme pressures in at least some sectors of the market place.

Mortgage credit in particular

This flexibility is particularly evident in the behavior of mortgage financing over the years. Mortgage credits and residential building expanded prominently in the recession year 1954, thereby moderating the cyclical decline in business activity and helping to pave the way for recovery. In 1956 and 1957, when other sectors of the economy were forging ahead and the requirements of other long-term borrowers were on the uptrend, housing starts and the demands for mortgage money tended to ease, but they resumed their advance early in 1958.

In this way, the flexibility of the financial market has helped allocate credit and has contributed to the moderation of the business cycle. Similarly, the moderate easing in homebuilding in prospect for 1960 may help establish the basis for a renewed rise in housing activity when the next cyclical downturn is at hand.

Despite these fluctuations, however, it is to be noted that mortgage financing has had a large call upon available investment funds throughout the postwar era. Chart 3 shows that, since the end of World War II, over one-third of the expansion in all types of credit—long, short, and Government—has been in mortgages. This was far greater than the rise in any other single category.

Furthermore, mortgage financing has preempted the lion's share of funds in the long-term credit markets. Mortgages have accounted for almost 55 percent of the net growth in long-term credit since World War II, and this proportion has not been impaired in recent years; in fact, in 1959, it was over 60 percent.

The short-term area

In contrast to the fairly stable trend of growth in long-term credit, the short-term credit sector displays wide fluctuations from year to year, as shown on chart 4. Expansion here has been sharpest during periods of rising economic activity and has tended to be considerably smaller when the trend levels off or declines. The explanation, of course, lies in the sensitive responsiveness of bank loans, especially to business, and of consumer financing, to changes in the economy. Other types of short-term credit are composed largely of net trade payables of noncorporate businesses, open market paper, stock market credit, and other loans to individuals.

In 1959, the amount of short-term credit outstanding increased by nearly $19 billion, partly because of the well-known upsurge in consumer credit, partly because the commercial banking sector furnished a record amount of funds to the short-term market. With the economy still embarked on a vigorous uptrend, it seems reasonable to expect a further large increase in short-term credit in 1960. If the projected excellent automobile year materializes, consumer credit will probably register another big rise, and business borrowings will continue high to support inventory building and further expansion of activity in general. However, the increase in 1960 at this time appears likely to be below the 1959 record.

THE SUPPLY OF FUNDS

The key development in the credit markets in 1959, as shown on chart 5, was the large provision of funds by sources other than savings institutions and commercial banks. These other holders financed over one-half of the year's entire increase in credit outstanding.[2]

[2] Savings institutions include life insurance companies, mutual savings banks, savings and loan associations, fire and casualty insurance companies, corporate pension funds, State and local government retirement funds, investment companies, and credit unions. The commercial banking system covers the commercial banks and the Federal Reserve banks. The "other" category includes business corporations, foreign investors, Federal agencies, individuals, and several miscellaneous categories.

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Developments in 1959

The savings institutions in 1959 supplied the markets with almost $24 billion in continuation of the gradual growth of recent years. The commercial banks, on the other hand, responded to the moderately restrictive credit policy by greatly reducing their provision of funds to the credit markets; the sharp rise in bank loans was partially offset by heavy sales of Government securities. Nevertheless, the commercial banking system (including the Federal Reserve) still supplied about $5½ billion of credit last year. The Government obligations sold by the commercial banks were taken up largely by other investors, mainly businesses and foreign holders. The amount of credit furnished by the "other" investor category as a group last year was an unprecedented $32 billion.

It is evident that the effect of credit policy in 1959 was not to cut off the growth in the volume of credit, which in fact increased far more than in any year since World War II, but to direct a considerably larger proportion into nonbank channels. This shift is evident from chart 5 and from the following tabulation (in billions):

Source of credit	1958	1959	Change
Savings institutions	$20.9	$23.7	+$2.8
Commercial banking	17.3	5.5	−11.8
Others	8.0	32.3	+24.3
Total supplied	46.2	61.5	+15.3

Projecting into 1960

Total credit expansion in 1960, as already noted, is here projected at a lower level than in 1959, but with the great bulk of the expected reduction attributable to the prospective improvement in the position of the Treasury. The savings institutions are expected to supply only a shade less than in 1959. The commercial banking system is also projected as providing amounts comparable in magnitude to 1959; this assumption is predicated on an increase in total bank deposits of some 2 to 3 percent, with the Federal Reserve increasing its holdings of Government securities in order to furnish additional reserves as well as to offset whatever further decline may occur in the monetary gold stock in 1960. It is thus assumed that other investors will meet a smaller share of total credit needs in the year ahead than was the case in 1959.

The savings institutions

The annual increases in the investments of savings institutions are shown on chart 6. Perhaps the most striking development in recent years has been the vigorous increase in the funds supplied by the savings and loan associations; these institutions have registered the most dynamic growth by far. However, they borrowed heavily from the home loan banks in 1959 to increase their takings of mortgages. Since the inflow of new savings in 1960 will probably not be significantly different while their borrowings are unlikely to expand much further, their contribution to the credit markets this year may be somewhat below 1959.

Deposits of mutual savings banks typically expand sharply during economic recessions, as in 1954 and 1958. As business recovers, deposit growth usually slows down. This was especially conspicuous in 1959, and for 1960, it seems reasonable to expect the supply of funds from the savings banks to continue relatively low. The fire and casualty insurance companies until recently suffered from adverse underwriting experience but their record has apparently improved in 1959 and some further growth in their additions to investments is expected this year. For corporate pension funds and public retirement funds (State and local governments), a continuation of the accelerated growth trend of recent years seems the most reasonable prospect. For life insurance companies, on the other hand, growth has tended to become less dynamic.

The investment companies have been expanding rapidly in recent years; their annual contribution to the investment markets has tripled since 1955. For 1960, their growth is projected slightly above the past year. Although these funds move more into equities than into fixed-income securities, their impact upon the credit markets is not dissimilar from that of the savings institutions. Consequently, the increase in the holdings of the investment companies, be they equity or debt, may justifiably be included with the supply of credit.

"Other" nonbank investors

The credit supplied by the heterogeneous group of investors classified as "others" fluctuates widely from year to year. In 1959, as chart 7 illustrates, this group supplied a record amount of credit to the market in response to the trend of business and higher interest rates. For 1960, each major class in this group is expected to furnish a somewhat smaller amount of credit than in 1959 although it must be cautioned that changes in the holdings of other investors are usually quite difficult to forecast.

Business corporations extend credit to the market mainly by carrying receivables, i.e., debts owed them by customers, and buying Government securities. Heavy purchases of Government securities are generally made in the later stages of a business recession, when inventories are usually being liquidated, and in the early phase of a business recovery, when profits are rising more rapidly than capital expenditures.

As the business expansion advances, however, profit margins tend to narrow, capital outlays rise, and business liquidity generally comes under pressure. Corporations then tend to reduce their holdings of Treasury obligations. In conformity with the economic outlook, it is assumed that business corporations will add further to their receivables but liquidate short-term Governments in the year ahead and, consequently, will finance less of the prospective credit expansion than in 1959.

Individual and other holders, as the chart shows, typically are attracted to the credit markets in a large way in periods of active economic activity and firming yields, as in 1955 through 1957. With the material easing of interest rates in 1958, these investors largely withdrew from the market and increased their holdings only slightly. In 1959, however, higher rates and yields again attracted these holders in substantial volume; in fact, they furnished an unusually large amount of funds to the credit market through the stepped-up buying of Treasury securities, including the magic 5s issued late last year, as well as through greater purchases of mortgages and State and local government obligations.

Foreign investors also were attracted by the higher returns available in the American credit markets in 1959 and, for the first time in recent financial history, greatly expanded their holdings; a contributing factor obviously was the substantial restoration of currency convertibility among major countries in recent years and the reestablishment of broad freedom of movement in international exchange markets. For foreign investors, as for individuals, the projected trend for 1960 indicates somewhat smaller takings of credit in 1960 than in 1959; an important consideration is that interest rates abroad have firmed very recently, and hence have become more attractive relative to market conditions in the United States.

THE COMMERCIAL BANKS

The commercial banking system occupies a strategic position in that it provides a major portion of the Nation's money supply. In addition, of course, the commercial banking system is a significant provider of credit; in the 6 years from 1954 through 1959, it increased its holdings of loans and investments by an estimated $46 billion, or about 19 percent of the total expansion in credit during this period.

Credit policy and bank credit

Credit is provided by the commercial banking system in the form of loans and investments; changes in the total of such loans and investments depend essentially upon the volume of reserves made available by the Federal Reserve. Since the Treasury-Federal Reserve accord in March 1951, the Federal Reserve has been following a flexible credit policy. This policy has two basic goals. One is to help moderate cyclical fluctuations in business activity; the other is to provide the credit needed to support economic growth.

A fundamental principle of countercyclical credit policy is that, when business sags, the central bank should actively ease credit in order to moderate the downtrend and facilitate recovery. The Federal Reserve eases credit by providing additional reserves to the member banks either through open market purchases or by reducing reserve requirments; the commercial banks are then able to expand their loans and investments, thereby feeding more credit into the economy, increasing its liquidity, and contributing to lower interest rates. The other half of a countercyclical credit policy is that when business activity is on a rapid rise or has reached a high level, action must be taken to provide reserves less liberally, more cautiously, and with greater restraint.

This flexible credit policy, designed to counteract cyclical fluctuations, is the accepted practice not only of the Federal Reserve but also of central banks in other economically developed nations throughout the world. It is difficult to avoid the conclusion that in this country and abroad flexible credit policy has helped importantly to shorten and cushion business recessions. Should the banking system continue to be fed liberally with reserves regardless of the state of business, the result would be to encourage credit expansion as actively in a boom as in a recession, with all its inflationary consequences. The alternative would be to refrain from furnishing reserves liberally during a recession. In either event, credit policy would no longer exercise a stabilizing influence and business fluctuations would probably become much more volatile.

Fluctuations in bank credit

As a result of countercyclical credit policy, the amount of credit supplied by the commercial banks tends to fluctuate inversely with the business cycle, substantial funds being provided during periods of business slack and considerably fewer funds when the business trend is upward. The resulting countercyclical behavior of total bank loans and investments is clearly evident on chart 8, which also shows the movements in industrial production in recent years.

Total bank credit increased sharply in the recession years 1954 and 1958 and advanced at a much more modest pace in periods when business was expanding or operating at a high rate, as in 1955–57 and again in 1959. Thus the behavior of bank credit in 1959 was not exceptional but conformed closely to the pattern of the past. The expansion in the amount of total loans and investments projected for 1960 is in line with past experience, based on the assumption, as already noted, that the Federal Reserve will provide sufficient reserves to permit an increase of some 2 to 3 percent in bank deposits.

The share of total credit expansion provided by the increase in the loans and investments of the commercial banks was close to 8½ percent in 1959, compared with 33 percent in 1958. Here, too, as shown on the lower panel of chart 8, the responsiveness to business fluctuations is clearly apparent, the percentage rising sharply in recessions and declining rapidly when business moved ahead. The proportion of the projected total credit expansion here assumed to be provided by bank credit in 1960 is also in reasonable accord with relationships in previous years of general economic prosperity.

Loans versus investments

Within the total of bank loans and investments established by the availability of bank reserves shifts occur in response to changes in the economy and especially in the demands for bank credit from business and individuals. Chart 9 shows annual changes beginning with 1952 in the main classes of bank assets—mortgage loans, other loans, U.S. Government and agency securities, and obligations of State and local governments. In recession years, such as 1954 and 1958, credit is easy and demands for loans other than mortgage loans are generally quite moderate. In such an environment the banks use the additional reserves provided by the Federal Reserve to expand their investments in Treasury and municipal obligations and to step up their mortgage loans in response to the countercyclical pattern of residential building activity.

Rising business activity is generally accompanied by a large increase in demands for bank loans by business and consumers. To meet these loan demands, the commercial banks usually reduce materially their holdings of Treasury securities, as shown on the chart; they also tend to cut back their purchases of municipal obligations and eventually reduce their takings of mortgages.

The changes in types of bank assets in 1958 and 1959 conformed closely to the pattern of the comparable phase of business activity in 1954 and 1955; then, too, the economy recovered from a recession, expanded vigorously, and reached new peaks. Under the assumption that credit policy permits a 2 to 3 percent advance in total loans and investments in 1960, the outlook is for further liquidation of Treasury securities, a nominal change in the holdings of municipals, a small addition to mortgage loans that in 1959, and another sizable increase in other loans, albeit of lesser magnitude than the record upsurge of last year.

This pattern of shifts in assets contributes toward minimizing cyclical fluctuations in business activity and is an essential ingredient of flexible credit policy. In a recession, when loan demands are slack, the commercial banks increase considerably their holdings of Government obligations, which helps ease interest rates while the concomitant rise in bank deposits adds to liquidity. The resulting greater availability of credit helps lay the basis for an ensuing business

expansion. In the early stages of a business recovery, the banks make large additions to their loan accounts; as the business expansion proceeds, the additions to loans become smaller. As long as this adjustment of bank assets in a period of buiness expansion is achieved without materially increasing total bank assets, an undue expanion in the money supply can be prevented.

The question of turnover

It has been alleged that even if a rise in total bank loans and investments in a business upsurge is curbed, the countercyclical aim of credit policy may still be defeated by the increased turnover of bank deposits as a result of the substitution of bank loans for Treasury obligations. The argument runs that the proceeds of bank loans are actively used while Treasury securities are presumably purchased out of idle funds. There may be some question whether this substitution actually raises turnover as importantly as some contend. Even if this should be so, however, it is doubtful whether the net effect is actually at cross-purposes to credit restraint.

Since the largest additions to bank loans under a countercyclical credit policy would be made in the earlier stages of a business expansion, any resulting rise in deposit turnover would come at a time when there is still considerable slack in the economy. Consequently, any inflationary impact attributed to this development would be fairly moderate and short lived. As the rise in business activity proceeds, countercyclical credit policy tends increasingly to restrain further shifts from Treasury securities into bank loans, thereby curtailing any increase in deposit turnover from this source. If credit policy is effectively used, therefore, the result is to strengthen rather than negate its countercyclical operation.

Banks "loaned up"?

It is sometimes asserted that, as the result of the large increase in loans in 1959, the commercial banking system, by and large, is already "fully loaned," and that another substantial increase in bank loans is not a reasonable expectation for 1960. Some light may be shed on this question by chart 10, which shows that the proportion of bank loans to total assets has indeed advanced very substantially in the postwar era for all major classes of banks and, at the end of 1959, was at or near the highest level attained in a generation.

However, while the chart shows that bank loans are tending to regain the importance to the banking system which they held before the great depression, it also shows that loan ratios are still appreciably lower than in the 1920's. Also, there is considerable diversity in the proportion of loans among the various categories of banks. The impact of loan demands in the postwar era has been strongest for the banks in New York City and Chicago (i.e., the central Reserve city banks) and only slightly less for the Reserve city banks. Other banks, which prior to World War II typically had higher loan ratios than the larger institutions, now carry a smaller proportion of their assets in loans than do the central Reserve and Reserve city banks.

Thus, while it is apparent that many commercial banks have come closer to a "fully loaned" position in recent years, there is still considerable lending power within the system as a whole. In view of the prospects for a further rise in bank assets and deposits and the possibility of some further reductions in bank holdings of Treasury obligations, it seems reasonable to conclude that the commercial banks still have room for further expansion in their loans.

However, it is also clear that the brunt of tight credit is bearing more heavily upon the banks in New York, Chicago, and other big cities, which are the major providers of credit to national corporations. Significantly lower than loan ratios prevail for the remainder of the banks as a group, the customers of which are mainly smaller and medium-sized enterprises. This casts considerable doubt upon the popular impression that small businesses are hit harder by tight credit conditions than are large national concerns.

MONEY SUPPLY AND LIQUID ASSETS

The objective of Federal Reserve policy, as already mentioned, is not only to counteract cyclical fluctuations in business activity but also to facilitate economic growth. It has been contended that too much emphasis has been placed upon the countercyclical goal, leading to undue restraint upon the money supply and liquidity, and that too little consideration has been given to meeting the needs of economic growth. However, a review of the factors involved does not support this criticism.

Money supply

Today, when the subject of economic growth holds a high priority in our thinking, the allegation that credit policy may be a retarding factor cannot be lightly dismissed. Economic growth is a complex phenomenon; not all increases in dollar expenditures or in physical output are equally meaningful for the achievement of sound and desirable growth. A full discussion of these problems is obviously beyond the limits of this memorandum; the question here is whether growth has indeed been hampered by credit restraint.

To shed some light on this question, chart 11 compares the expansion of bank credit (total loans and investments of commercial banks) with the growth of the gross national product, measured both in current dollars and in physical volume. The chart covers the period since the introduction of flexible credit policy after the Treasury-Federal Reserve accord in March 1951. It is readily apparent that bank credit in this period has expanded about as fast as the dollar measure of the gross national product, and considerably faster than the physical volume of output.

The lower panel of the chart further points up the conclusion that total bank credit outstanding is as plentiful, relative to the dollar measure of current output, as it was in 1951; indeed, the percentage of loans and investments to the annual rate of the gross national product at the end of last year, at 39.6 percent, was a shade above the 39.2 percent ratio of 1951. Measured against real growth, moreover—that is to say, against the growth in physical volume—bank credit is significantly more plentiful today than in 1951, since part of the expansion in credit went to support the inflation of costs and prices. The pertinent figures show the amount of bank credit at 44.9 percent of real output at the end of 1959, compared with 38.2 percent 8 years earlier.

The effects of recent credit policy on bank credit and the money supply are illustrated on chart 12. The impact of flexible credit policy is conspicuous. The volume of bank credit (upper panel) advanced very sharply with the easy credit policy adopted to combat the recession of 1957–58, and climbed more slowly as the shift toward greater restraint took hold in 1959. Even in 1959, however, the level of bank credit was significantly above the previous year; in fact, total loans and investments of commercial banks in 1959 averaged 6 percent higher than in 1958. Quite clearly, Federal Reserve policy has slowed, but has far from halted, the sustained growth in bank credit.

This general pattern applies equally to the expansion in the money supply, which is conventionally defined as the sum of demand deposits adjusted and currency outside banks (lower panel). Here, too, a large increase in 1958 was followed by a smaller rise in 1959, but although the money supply at the end of last year was not far above the end of the previous year, the average level in 1959 was 3.2 percent above 1958.

Shifts to liquid assets

Furthermore, the effect of credit restraint on the money supply here appears overstated as the result of using the most restrictive definition of the money supply. This definition, as noted, takes into account only that portion of bank deposits which is payable on demand. In recent years, a growing number of businesses and individuals have been shifting funds from checking accounts into time deposits and other interest-bearing media, such as savings accounts and holdings of short-term Treasury securities. These instruments now fulfill substantially the same functions for their holders as demand deposits; if such balances are considered, it becomes evident that liquidity in the economy, in the period since the introduction of flexible credit policy, has not only been well maintained but has actually increased.

The shift from cash to other liquid assets is indicated in chart 13, which shows the ratio of the money supply, including various classes of near-money instruments, to the gross national product in current dollars. Because of the huge inflation of demand deposits in World War II, the money supply narrowly defined ("Money supply I") has been in a persistent decline, relative to gross national product, throughout the postwar era, but the pace of this decline has slowed markedly since 1951. A somewhat broader concept of the money supply, however, includes time deposits of commercial banks, and if this definition is used ("Money supply II"), the ratio to gross national product shows a smaller reduction and, in fact, a leveling off in recent years.

Moving one step further to include mutual savings bank deposits and shares of savings and loan associations ("Liquid assets I") indicates not only no decline in liquidity but in fact a rising trend in recent years, and relative to the current

dollar amount of output, these aggregate balances are larger than in the early 1950's. This is so, moreover, even though these balances were clearly exposed to the effects of credit policy; as the chart shows, these assets increased considerably, relative to gross national product, in years of business downtrends and easy credit and sagged somewhat when business was expanding and the Federal Reserve was exercising restraint.

In reviewing changes in liquid assets, finally, there are good reasons for including Treasury obligations of up to 1 year maturity which are held outside the banking system. In recent years, corporate treasurers in particular have gradually adopted the practice of holding a greater portion of their liquid assets in such securities instead of in checking accounts. Consequently, the top line ("Liquid assets II") on chart 13 shows the relationship of all liquid assets (currency, demand deposits, saving accounts, and short-term Treasury obligations) to the gross national product. Here there is an almost uninterrupted rise since 1951, and the ratio at mid-1959 was the highest in a decade. It should be obvious that if there is any quarrel with the growth rate of the American economy in the 1950's, the fault cannot be ascribed to an unduly restrictive credit policy or to a shortage of liquid assets.

Liquid assets versus real growth

The analysis so far has referred to the relationship between the money supply or all liquid assets on the one hand and the gross national product measured in current dollars on the other. Such a comparison, however, may conceivably be challenged as implying that the money supply should be sufficient not only to facilitate physical growth but also to allow for the validation of price increases. To meet this point, the comparison on chart 14 is with the physical volume of gross national product, expressed in dollars of constant (1954) purchasing power.

This chart clearly indicates that the money supply even in its narrowest sense ("Money supply I") has declined only very slightly in relation to real output since 1951. Taking into account the time deposits of commercial banks ("Money supply II"), it has fluctuated around a rising trend over this period. A very substantial increase is evident as savings accounts ("Liquid assets I") and short-term Treasury securities ("Liquid assets II") are included.

It is evident that the supply of liquid assets has increased faster than the current dollar measure of output and very much faster than the real output of the economy over the years. If real growth has not been greater, the reason is not a shortage of credit or liquidity. Since part of the increase in the dollar value of the gross national product was absorbed by the persistent inflation of costs and prices, the real question would seem to be not whether credit, fiscal, and debt management policies in concert have discouraged economic growth by being too restrictive but whether they have encouraged price inflation by being too liberal.

INTEREST RATES

The advance in interest rates in 1959 continued a cyclical movement that began when the economy turned from recession to recovery in 1958. Although last year's rise in interest rates attracted widespread attention, it should be emphasized that interest rates have done no more than return closer to the levels that normally prevailed in periods of good business prior to the great depression. Moreover, representative rates and yields in the United States, especially on long-term credit, continue to be about the same or below those in a number of other leading industrial countries.

The 1959 advance

The behavior of various market yields last year is illustrated on chart 15. It is apparent that the rise was most pronounced from the spring of the year to the autumn. In the last few months of 1959, interest rates tended to ease somewhat but firmed again and by the close of the year were at or near their highs for recent financial history. The movement engulfed all classes of rates

and yields, but was most pronounced in the short- and medium-term area, as the following tabulation indicates (in percent):

Security	End of 1958	End of 1959	Increase
Treasury bills (3 months)	2.69	4.52	1.83
Commercial paper (4 to 6 months)	3.25	4.88	1.63
Treasuries (3 to 5 years)	3.70	4.99	1.29
Treasuries (long-term)	3.83	4.37	.54
Corporate bonds (AA)	4.19	4.77	.58
Municipal bonds	3.40	3.77	.37

The forces underlying this vigorous rise in the interest rate structure have already been reviewed—a recordbreaking expansion in total credit, including mortgage financing, business borrowings, and consumers debt, which was compounded by huge Treasury borrowings. A large portion of this increase, particularly in the Treasury debt, was met by corporate business investors, foreign holders, and individuals who entered the credit mrakets in a big way as interest rates reached levels they found attractive.

The especially sharp incresae in short- and medium-term interest rates was a distinctive feature of the credit markets last year. To some extent, of course, this behavior was to be expected, since shorter rates tend to be more sensitive to fluctuations in business and credit conditions and are more directly affected when the economy expands. However, the pressures in the short- and medium-term markets in 1959 were exceptionally strong because of the large volume of Treasury cash financing.

After absorbing gross new Treasury borrowings of $14 billion in the first half of the calendar year 1959, the markets were required to meet an additional $12.8 billion in the second half, a time when other credit requirements were already being boosted by seasonal forces as well as by the rise in general business activity. Moreover, under prevailing market conditions the 4¼-percent interest-rate ceiling on new Government bond issues compelled the Treasury to compress all its financing into the shorter area of the market. The result was to intensify the upward pressures on yields of short- and medium-term Treasury securities, and as these pressures spread to other parts of the credit markets, bond yields, too, were affected.

That the Treasury's debt operations have a real bearing upon the behavior of interest rates is illustrated on chart 16, which compares the fluctuations in the yield on Treasury bills with changes in the Treasury's short-term marketable debt in the 1954–57 period and in the generally similar phase of the current business cycle. It is apparent that the movements of the Treasury's short-term debt have exercised an influence upon the rate the Treasury has had to pay for short-term credit. In 1954 and 1958, of course, yields were pushed down drastically by an aggressively easy credit policy; yields advanced as the economy rebounded to new heights in 1955 and again in 1959. In 1954–55, however, the pace of the advance in the Treasury bill yield was moderated by the improvement in the Treasury's budget position; only later did the Treasury's short-term debt resume its rise, and the bill yield with it. In 1959, on the other hand, the budget and debt position of the Treasury was much more unfavorable, and this difference was clearly mirrored in last year's sharper rise in bill yields and other short-term rates.

Essentially, therefore, the general advance in interest rates in 1959 was the work of market forces rather than of the Federal Reserve. Assuredly, the Federal Reserve made reserves less freely available than during the 1958 recession but it did not increase the pressure on reserve positions after the middle of 1959; in fact, as measured by the average amounts of net borrowed reserves, the Federal Reserve eased pressures in the second half of the year; it moderated the tightening forces of the marketplace by supplying significant amounts of credit to meet seasonal needs and to facilitate Treasury operations.

Some pertinent relationships between recent Federal Reserve policy and market yields may be gleaned from chart 17, which shows the amount of net free or borrowed reserves, the discount rate (Federal Reserve Bank of New York), and the rate on 3-month Treasury bills. It is evident from the chart that despite the relaxation of pressure on reserves by the Federal Reserve in the latter part of 1959, interest rates continued to move irregularly upward; without Federal Reserve intervention, the upward pressures would presumably have

been even stronger and interest rates would have advanced further. Moreover, the chart shows that in successively raising the discount rate from its recession low of 1¾ percent to the 4-percent level at the end of 1959, the Federal Reserve repeatedly followed rather than led the market.

Perspective on interest rates

Current levels of interest rates are occasionally described as abnormal, implying unfavorable repercussions upon the credit markets and the economy. It is true that interest rates today are generally the highest in about three decades. However, it is surely not unreasonable to identify abnormality more closely with these past decades, when credit conditions were shaped largely by the depression, World War II, and its aftereffects, rather than with the present. Related to the current trend of business, the historical record of the credit markets, and the present state of the world economy, today's interest rates are neither extraordinary nor excessive.

Rising interest rates are a normal and natural accompaniment of rising economic activity; as output grows and more credit is used the cost of financing tends to increase. At the same time, higher rates attract more funds to the market, so that credit is able to expand, sometimes spectacularly, as it did last year. Chart 18 clearly demonstrates that higher interest rates go hand in hand with an increase in business. This is true not only in the United States but in economically advanced countries elsewhere throughout the free world.

Nor is the present level of interest rates an unprecedented and alarming phenomenon. For a look at past history, chart 19 shows the behavior, over the past 90 years, of long-term rates (as measured by the yield on high-grade corporate bonds) and of short-term rates (as reflected by the prime commercial paper rate). The chart also shows the fluctuation in the wholesale commodity price index.

It is apparent that interest rates move over a wide range, and that short-term rates have always been more volatile than bond yields. The pattern of rates and yields clearly reflects the distortions caused by wars, the money panics of our earlier history, and the extremely easy credit of the great depression. It is also apparent, however, that the present interest rate level falls in neither extreme, but is within the lower range that prevailed in earlier periods of active credit demands, such as in the decades before World War I and again in the 1920's. In other words, the current level of interest rates appears generally consistent with periods marred neither by major international conflicts nor by deep and sustained economic downtrends.

A further observation is that interest rate movements over the long term bear a resemblance to the trend of commodity prices. When prices are in a rising trend, the pressures upon interest rates also seem to be on the upside; when prices ease, interest rates tend to soften. Since rising prices add to the need for financing on the one hand and penalize savers on the other, the relationship is not altogether fortuitous. The long record suggests that inflation makes for higher rather than lower interest rates; one may conclude that attempting to hold interest rates down through the inflation of central bank credit would be essentially an inconsistent and self-defeating proposition.

This conclusion seems substantiated by the more recent historical record, shown on chart 20, which clearly illustrates the subnormal levels to which interest rates were driven in the years of the great depression. The interest rate structure of the 1930's was adopted as the pattern for the financing of World War II, but at the cost of storing up great inflationary pressures which erupted in strength once the host of direct wartime controls over prices, wages, and materials were lifted. As a result, despite the hyperliquidity with which the economy emerged from the war, and despite the "pegging" of Government security prices by the Federal Reserve until 1951, interest rates began to advance as early as 1946. Except for the brief interruptions during the recessions of 1953–54 and 1957–58, they have continued on the uptrend since that time.

Even so, short-term rates today, except on Treasury securities, are not significantly above their average during the middle years of the 1920's, and corporate and municipal bond yields are still considerably lower. This is all the more remarkable since our present highly progressive tax structure encourages borrowing and seriously impedes the accumulation of individual savings. After allowing for the drastic increases in income tax rates, net interest costs to borrowers and net yields to investors are far less today than in this earlier period. In comparing the interest rate structure at the end of 1959 with that of the 1920's, the years 1920–21 and 1929 have been omitted because of the unusual

pressures in the credit markets in those years; the comparison thus is as follows (in percent):

Security	Average 1922–28	End of 1959	Now versus then
Commercial paper (4 to 6 months)	4.41	4.88	+0.47
Treasuries (short-term)	3.36	4.52	+1.16
Treasuries (long-term)	3.85	4.37	+.52
Corporate bonds (AA)	5.19	4.77	−.42
Municipal bonds	4.13	3.77	−.36

The higher yields on Government securities in today's markets reflect partly the accumulation of large budget deficits in our times and the growing problems of Treasury debt management; in the 1920's, in contrast, the Treasury was consistently operating at a surplus and the retirement of Government debt helped release funds to private borrowers, and interest rates following a declining trend. Another factor is the elimination of the tax exemption which Treasury bonds enjoyed in the earlier period. Finally, unlike in the 1920's, the Federal Government in recent years has equipped a growing amount of private indebtedness—of homeowners, businesses, and others—with its insurance or guarantee, as shown on chart 21, and since most of these obligations carry interest rates well above the statutory 4¼-percent ceiling on Treasury bonds, the Treasury is in effect required to compete against itself in the credit markets under adverse conditions.

A final but important consideration is that interest rates in the United States are by no means high in comparison with the rest of the world. Government bond yields are generally considerably higher abroad. Short-term rates have advanced more rapidly in this country than in most of Western Europe, where economic activity until recently has been somewhat sluggish, but the discount rate in a number of major countries is at the same level as in the United States, and in Canada and the United Kingdom it is considerably higher. The following table shows yields and rates as of the latest available dates; since these dates vary, the figures are not strictly comparable but are presumed sufficiently representative to illustrate the point.

Country	Government bond yields	Discount rates
Canada	5.60	5.11
Germany	5.40	4.00
Italy	5.37	3.50
France	5.22	4.00
United Kingdom	5.00	5.00
United States	4.37	4.00
Switzerland	3.29	2.00

Prospects for 1960

The behavior of interest rates consistently tends to follow rather closely the course of business activity, and since the current outlook is for a year of active business, with output rising to new peaks and with higher prices in prospect, it is reasonable to expect interest rates to remain firm for some time to come.

Total credit requirements in 1960, as previously reviewed, are likely to be lower than in 1959, essentially because of the anticipated reduction in the Treasury debt. However, the experience of 1956, which followed a year of sharp credit expansion, indicates that the trend of interest rates may continue upward even if, as was the case then, the rise in total financing requirements slackens. Rising business activity generally makes inroads upon the liquidity of business concerns, which will presumably be adding to their inventories and receivables in 1960, and hence are expected to be net sellers of Government securities. The commercial banks, too, will probably liquidate additional Government securities to meet a further increase in loans.

The credit markets may have already discounted at least some of the upward pressures on interest rates likely to be at work in the months ahead. In any event, it seems reasonable to assume that much of the cyclical advance in interest rates and market yields has already taken place. A major easing in

credit conditions and interest rates, however, is not in sight unless business prospects begin to show some deterioration or unless the deep-seated, persistent inflationary trends and expectations can be brought to a halt.

SOME KEY CONSIDERATIONS

As always, of course, the outlook is clouded by a number of questions and uncertainties. One question, which has been raised on occasion in recent months, is whether 1960 may bring a shortage of credit which will put an end to the rise in business activity or possibly even lead to a credit crisis and a spiral of credit liquidation. A major problem is posed by the progressive increase in the amount of Treasury debt approaching maturity. Finally, the substantial restoration of free international exchange markets has made American and foreign investors more sensitive and alert to interest rates elsewhere, so that developments abroad are no longer irrelevant to the credit markets in the United States.

A credit shorage?

Although prospects are for a continuation of fairly tight credit conditions as long as the trend of the economy points upward, this tightness is attributable to the strength of private demands for funds rather than to any curtailment of the supply. Funds invested by the savings institutions in 1960, as previously reviewed in some detail, are likely to approximate the record amount of nearly $24 billion in 1959. The commercial banks appear to have sufficient lending capacity for a further sizable expansion of loans in the year ahead. Business corporations will presumably be supplying fewer funds to the credit markets in 1960, and foreign holders may also be expected to be less active buyers of American credit instruments. However, the need to draw on these sources will be less with the shift in the Treasury budget from a large cash deficit in 1959 to a small cash surplus. Thus, there is little danger that the economy will be starved for credit to finance a further growth in real output in 1960.

There is a school of thought which contends that tight credit may bring on a downturn in business activity. This is a misreading of cause and effect. The reason for tighter credit and higher interest rates as the business cycle approaches its peak is the growing pressure of credit demands upon liquidity positions. Today, as in similar stages of the business cycle in the past, the problem is to prevent credit expansion from becoming excessive and thus encouraging speculation or feeding inventory accumulation, capital spending, and other activities at a faster pace than is sustainable over an extended period. To the extent that this is achieved, the prospects for extending the life of the current business advance and moderating any subsequent downtrend are increased.

If, however, we should attempt to prevent interest rates from rising with the trend of business by requiring the Federal Reserve to inject ever larger amounts of bank reserves into the credit system, the results would be exactly the opposite. Interest rates might ease temporarily, but liquidity would be increased, unsustainable expansion in spending and investing would be encouraged, the inflationary potential would be enhanced, and economic forces would eventually exert an even stronger upward push upon interest rates. To prevent this consequence would gradually require the introduction of a host of other economic controls, such as controls over prices, capital outlays, consumer spending and the like, to replace the use of credit policy as a tool for economic stabilization.

It is precisely the excessive expansions of credit that in our earlier history has led to credit crises, liquidation spirals, and sharp corrections in business. The present relatively tight conditions in the credit markets are an important safeguard against the repetition of such events.

The Treasury's financing problem

Despite the improvement in the Treasury's cash budget this year, the problems of debt management continue to be serious. As of the start of 1960, the Treasury faced maturities of $48.3 billion (exclusive of $31.6 billion of weekly bills and tax anticipation bills outstanding) over the year ahead. In addition, even though no net increase in the debt is anticipated for 1960 as a whole, the Treasury will still need to make large cash offerings to cover net redemptions of savings bonds, attrition on maturing issues, and the seasonal deficit in the second half of the year.

Moreover, the maturity of the oustanding marketable debt is becoming progressively shorter. As chart 22 demonstrates, the amount of marketable securities maturing within 1 year has been on a rising trend for years; it increased

from about $72½ billion to almost $80 billion in 1959. The debt maturing within 5 years spurted to a new peak of $141½ billion at the end of 1959, compared with $125 billion a year earlier. Should the Treasury in 1960 continue to be limited to the issuance of maturities below 5 years, by the end of the year nearly 80 percent of the currently outstanding marketable debt will be within this maturity range.

Underlying this rapid and persistent growth of the Treasury's near-term debt is, in the first instance, the fact that budget deficits have been large and frequent, and budget surpluses few and small. In other words, even though the three business recessions since the end of World War II have been brief and moderate, we have not succeeded in establishing a cyclically balanced budget; on the contrary, as in 1955 and even more emphatically in 1959, large Treasury deficits have had to be financed in years of high and rising business activity, when private financing requirements were expanding and the competition of the Treasury materially added to the pressures in the credit markets.

The corollary to this development, as shown on chart 23, is that the Treasury at such times has to rely mainly on marginal holders of Government securities, who alternate in buying and selling from year to year, and hence are interested in obligations of fairly short maturity. These holders include commercial banks, which adjust their portfolios in response to credit policy and loan demands; business corporations, which increase or decrease their investments with changes in their liquidity and their tax liabilities; and, as last year, foreign holders, many of whom shift their funds in response to interest rate differentials among the world's money markets. The chart clearly illustrates that the Treasury lacks a broad and dependable market for its securities among savings institutions or, for that matter, among any other major group of investors.

The obvious conclusion is that, if the Treasury is to ease its debt management problems, it must achieve substantial budget surpluses in years of economic expansion, so that instead of crowding other borrowers at such a time, it can reduce the debt and thus supply funds to the market. In addition, if the Treasury is to compete effectively for savings, it should not be shackled by an arbitrary ceiling on interest rates, but should be free to adjust the yields and maturities of its offerings to the realities of the marketplace. Finally, the continuing rapid increases in the volume of federally insured and guaranteed obligations make it increasingly difficult for the Treasury to find a market for its own long-term securities, thereby impending the attainment for a better balance in the maturity distribution of the Treasury debt.

OUR INTERNATIONAL POSITION

Over the past 2 years, for the first time since the early 1930's, the significance of the U.S. balance of international payments has been brought home to the credit markets and, indeed, to the American economy as a whole. Our deficit on international account has increased, the dollar has suffered spells of weakness in foreign markets, gold has been withdrawn in large amounts, and our short-term indebtedness to foreigners has climbed rapidly.

The U.S. gold stock, shown on chart 24, entered upon a declining trend more than a decade ago with the gradual rebuilding of the monetary reserves of other countries. A sudden and dramatic drain, however, began early in 1958, when the economy was headed downward, a large budget deficit was in prospect, credit policy was aggressively easy, and there were fears abroad that the United States was heading toward large-scale inflation and a devalution of the dollar. As these uncertainties diminished, the gold outflow began to slacken; nevertheless, the United States lost some $3.4 billion, or about 15 percent of its monetary gold stock in the past 2 years.

To be sure, not all of the recent gold losses may be associated with distrust of the dollar. Many Western European countries have employed energetic fiscal, credit, and other policies to check inflation and these policies have borne fruit. Moreover, their exports to the United States have risen while their imports have been held down. As a result, the United Kingdom and various continental countries have taken advantage of the improvement in their balance of payments positions to add to their gold reserves more rapidly than had been possible in earlier years. At the same time, they have restored substantial freedom of exchange and cut back their import restrictions, including restrictions against imports from the United States. The United States, despite the sustained decline in the gold stock since early 1958, still holds $19½ billion, or nearly one-half of the free world's gold reserves, as the chart illustrates; the strengthening

of the currencies of our friends abroad is a constructive development and need not lead to fears for the safety of the U.S. dollar.

More disturbing, however, is the decline in the "free" gold reserve of the United States. Since about $12 billion of our gold stock is by law required to be held as a 25 percent reserve against Federal Reserve note and deposit liabilities, only some $7½ billion is available to meet foreign withdrawals. As a result, there is concern both at home and abroad lest further inroads on the "free" gold cause an embargo to be placed on gold sales, which would mean a devaluation of the dollar, even though our total gold reserve might still be huge. It would therefore be desirable to remove the outmoded statutory reserve requirement in order to assure the world that we shall continue to meet our obligations in full. At the same time, it is imperative that we follow credit and debt management policies which recognize the new conditions in the international economy.

That credit conditions in the United States have a direct bearing on gold movements is illustrated on chart 25, which compares the movement in our gold stock over the past 2 years with the behavior of short-term rates (here represented by the rate on new Treasury bill issues). It is readily apparent that the heaviest outflow of gold occurred during the period of aggressively easy credit policy in 1958 and that as short-term rates advanced, the drain on the gold reserve began to ebb.

To some extent, this reduction in the pace of gold losses is attributable to the improved confidence in the dollar as the economy recovered from the recession, the Treasury budget moved closer toward a balance, and the Federal Reserve changed its credit policy in line with accruing evidence of rising business activity. An important consideration, however, is that the better yelds available in the American credit markets induced foreign holders of claims to dollars to withdraw less gold and, instead, to increase materially their investments in Treasury bills and other short-term assets.

With our balance of payments continuing to incur a deficit, the slackening in gold withdrawals was accompanied by a big increase in foreign holdings of short-term dollar assets. As shown on chart 26, these soared in 1959 to reach about $19½ billion at the end of the year. The recordbreaking rise of more than $3¼ billion demonstrates that confidence in the U.S. dollar is still high.

However, the huge increase in foreign dollar assets also enhances our exposure to large and sudden withdrawals either as a result of renewed distrust of the dollar or in response to significant differentials in short-term interest rates that would attract funds to foreign financial centers. This could confront the Federal Reserve with troublesome problems in its use of credit policy to counteract a business downturn in the United States. An important easing of credit, if limited to this country, might well lead to large foreign sales of short-term Government and other securities and a substantial outflow of gold.

Therefore, while appropriate credit policy in 1960, as in 1959, can temper the drain on our gold reserves, obviously it cannot correct our balance-of-payments problem. As long as the deficit in our balance of international payments remains substantial, a reduction in the gold outflow simply means that the deficit is being settled through correspondingly larger additions to foreign holdings of short-term dollar assets.

The prospects are that the United States will show another substantial deficit in its balance of payments in 1960. Whether this deficit will be settled through gold or through additions to foreign holdings of short-term dollar assets will depend upon interest rate movements in foreign and American credit markets and upon the state of foreign confidence in the dollar, including particularly confidence that the present price of gold at $35 an ounce will be maintained. Perhaps the best current guess is that we shall lose additional gold and incur more short-term liabilities to foreigners this year.

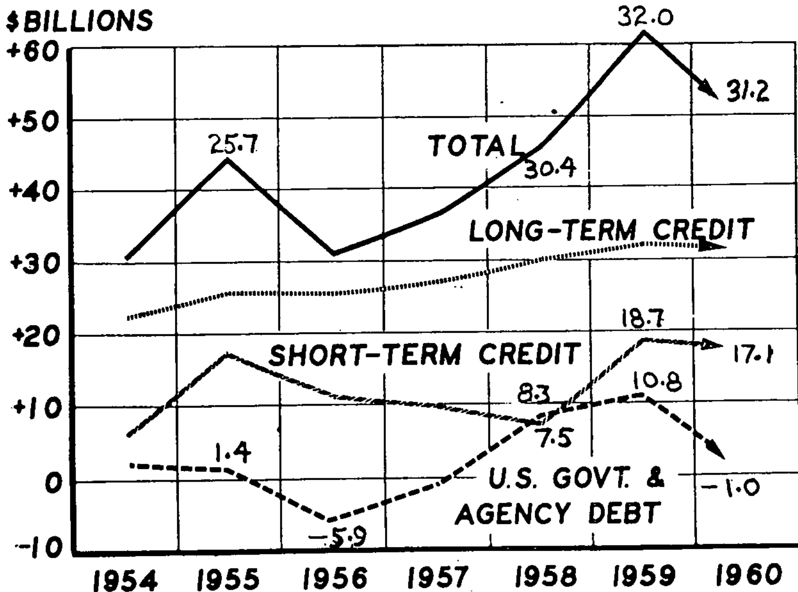
Obviously, this condition cannot be allowed to persist indefinitely. If the possibility of unsettlement in the credit markets as the result of volatility in foreign holdings is to be minimized, the deficit in our international accounts must itself be reduced to more manageable proportions. This requires, among other things, making American goods more competitive in world markets, reappraising our foreign economic programs, and undertaking a determined effort—encompassing fiscal, credit, debt management, and other economic policies—to halt the relentless deterioration, year after year, in the purchasing power of the dollar.

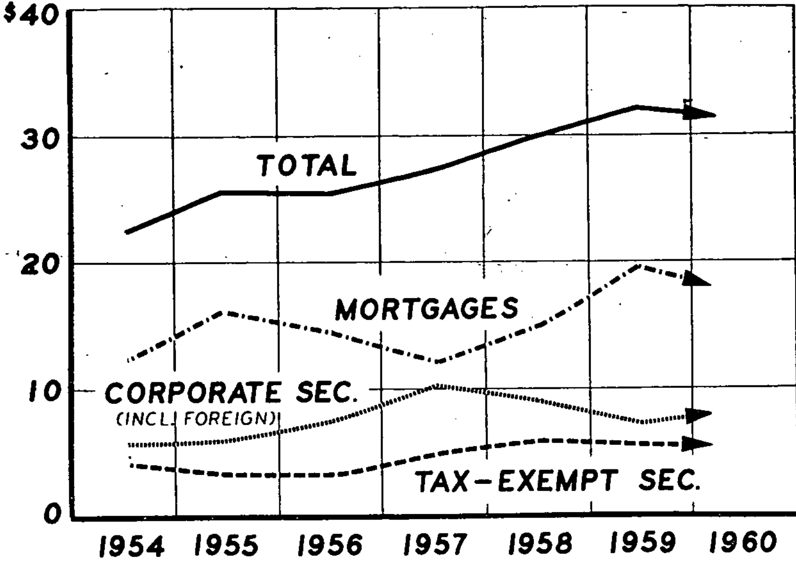
The U.S. dollar is a key currency, and loss of confidence in the dollar would be a most serious blow to the economic and political strength of the entire free

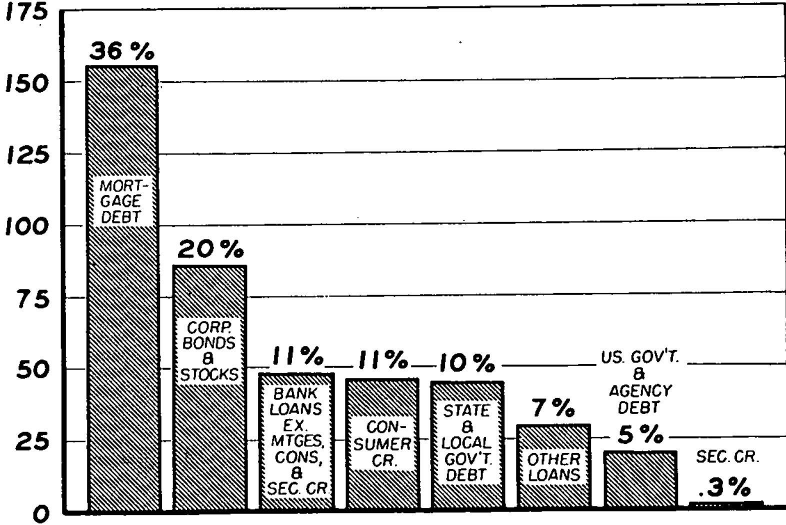
world. Whatever we do, or fail to do, toward keeping the dollar strong is being watched keenly by our friends and our foes abroad. Every sign of a renewed wage-cost-price spiral, every leaning toward inflationary credit policies or large budget deficits in the United States, and every proposal to reduce interest rates by force through the use of central-bank credit, affects the world's appraisal of the dollar. Preserving a stable dollar is a prerequisite not only to economic progress and real growth at home but also to the maintenance of our economic leadership in world affairs.

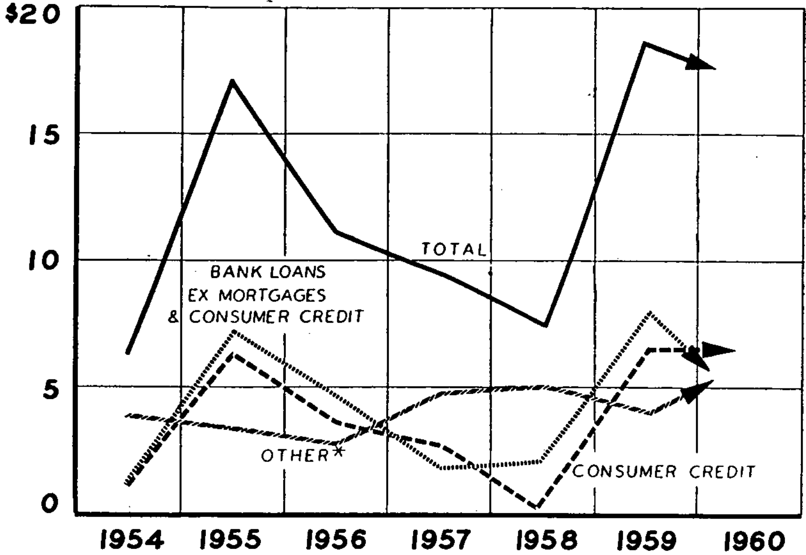
LIST OF CHARTS

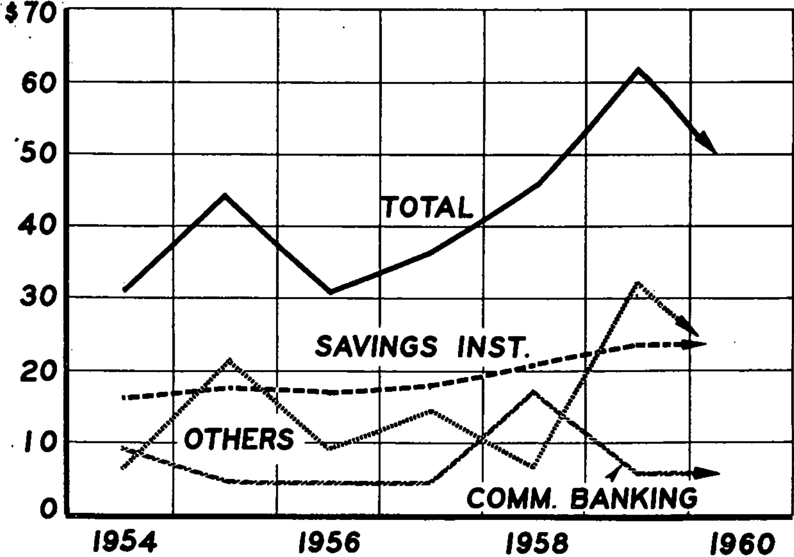
Chart No.
1. Expansion in credit.
2. Expansion in long-term credit.
3. Credit expansion since World War II.
4. Expansion in short-term credit.
5. Sources of credit.
6. Credit supplied by savings institutions.
7. Credit supplied by others.
8. Credit supplied by commercial banks and industrial activity.
9. Types of bank credit supplied.
10. Loan ratios of commercial banks.
11. Bank credit and GNP.
12. Bank credit and the money supply.
13. Money supply and liquid assets to GNP.
14. Money supply and liquid assets to real GNP.
15. Behavior of market yields.
16. One-year marketable Treasury debt and Treasury bill yields.
17. Net borrowed reserves and interest rates.
18. Interest rates and production during upturns.
19. Trends in prices and interest rates.
20. Interest rates and prices.
21. Loans with Federal guarantees or insurance.
22. Maturity of marketable Treasury debt.
23. U.S. Government and agency debt held.
24. Gold reserves, United States versus rest of world.
25. Gold movements versus Treasury bill rates.
26. Foreign dollar balances.

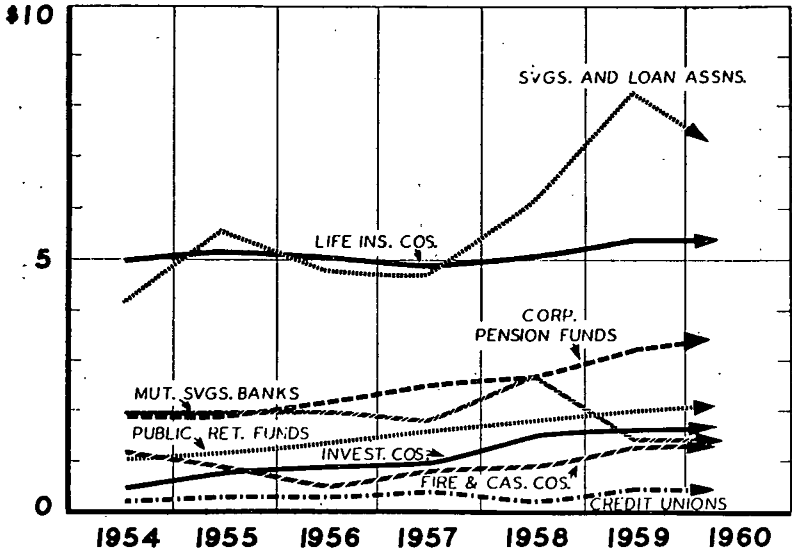


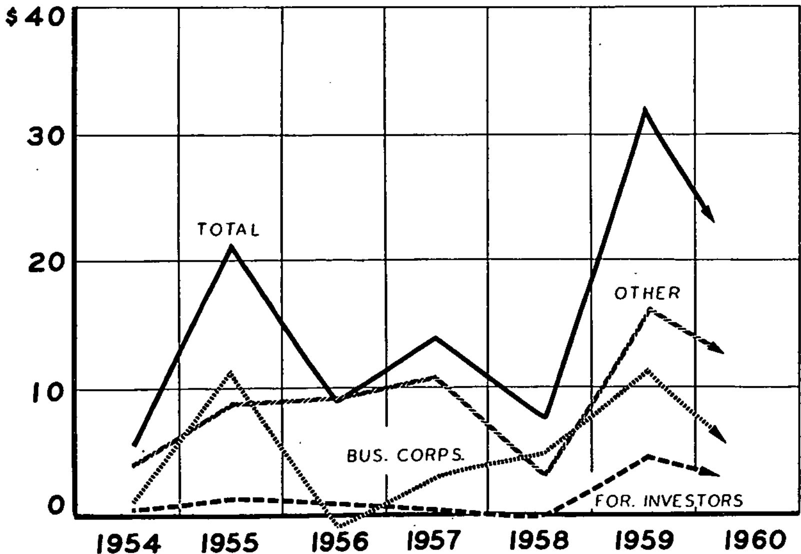

2
EXPANSION IN LONG-TERM CREDIT
BILLIONS
$40
30
20
10
0
TOTAL
MORTGAGES
CORPORATE SEC.
(INCL. FOREIGN)
TAX-EXEMPT SEC.
1954
1955
1956
1957
1958
1959
1960

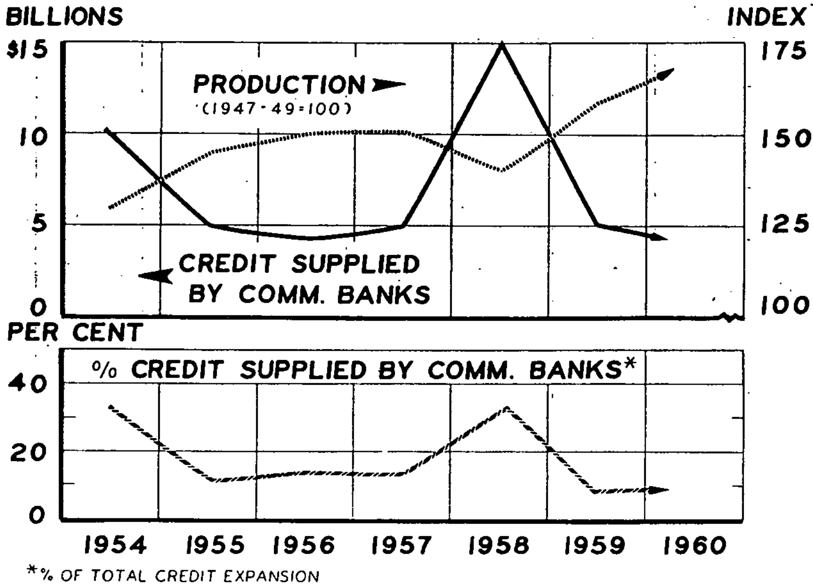

3
CREDIT EXPANSION SINCE WORLD WAR II*
BILLIONS
$175
150
125
100
75
50
25
0
36%
MORT-GAGE DEBT
20%
CORP. BONDS & STOCKS
11%
BANK LOANS EX. MTGES, CONS, & SEC. CR.
11%
CON-SUMER CR.
10%
STATE & LOCAL GOV'T. DEBT
7%
OTHER LOANS
U.S. GOV'T. & AGENCY DEBT
5%
SEC. CR.
.3%
* NET INCREASE IN OUTSTANDINGS OVER THE YEARS, 1946-1959.

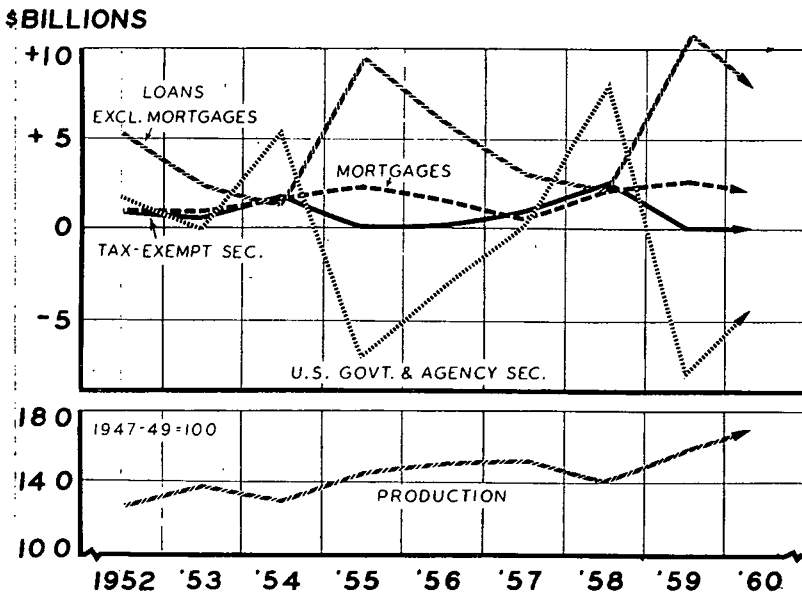

4
EXPANSION IN SHORT-TERM CREDIT
BILLIONS
$20
15
10
5
0
TOTAL
BANK LOANS
EX MORTGAGES
& CONSUMER CREDIT
OTHER*
CONSUMER CREDIT
1954
1955
1956
1957
1958
1959
1960
* NET TRADE PAYABLES OF NONCORPORATE BUSINESS,
POLICY LOANS, NONBANK STOCK MKT. CREDIT & OPEN MKT. PAPER


5
SOURCES OF CREDIT
BILLIONS
$70
60
50
40
30
20
10
0
TOTAL
SAVINGS INST.
OTHERS
COMM. BANKING
1954
1956
1958
1960


6
CREDIT SUPPLIED BY SAVINGS INSTITUTIONS
BILLIONS
$10
5
0
SVGS. AND LOAN ASSNS.
LIFE INS. COS.
CORP. PENSION FUNDS
MUT. SVGS. BANKS
PUBLIC RET. FUNDS
INVEST. COS.
FIRE & CAS. COS.
CREDIT UNIONS
1954
1955
1956
1957
1958
1959
1960

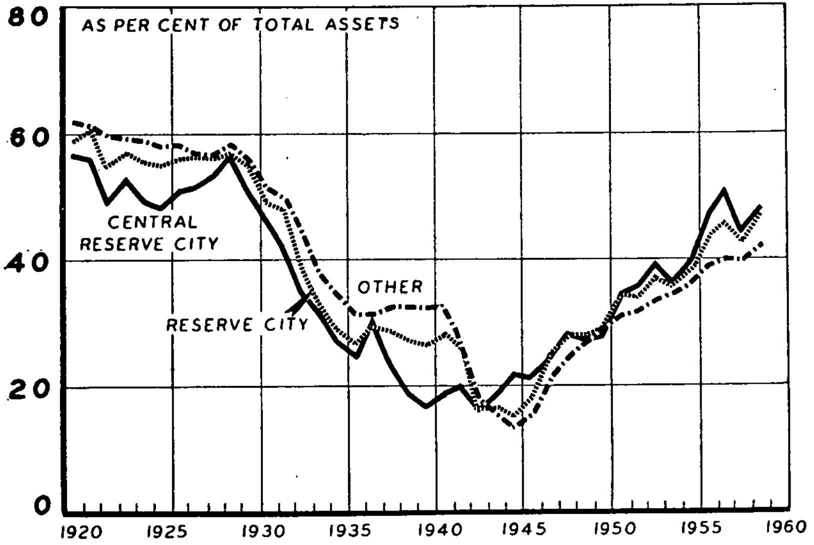

7
CREDIT SUPPLIED BY OTHERS*
BILLIONS
$40
30
20
10
0
TOTAL
OTHER
BUS. CORPS.
FOR. INVESTORS
1954
1955
1956
1957
1958
1959
1960
* OTHER THAN SAVINGS INSTITUTIONS & THE BANKING SYSTEM

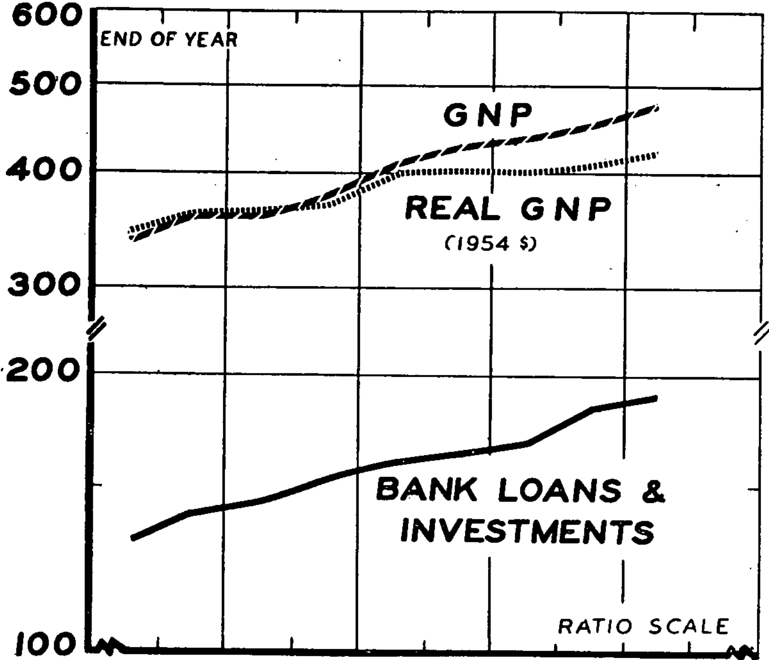

8
CREDIT SUPPLIED BY COMMERCIAL BANKS
& INDUSTRIAL ACTIVITY
BILLIONS
INDEX
$15
10
5
0
175
150
125
100
PRODUCTION
(1947-49=100)
CREDIT SUPPLIED
BY COMM. BANKS
PER CENT
% CREDIT SUPPLIED BY COMM. BANKS*
40
20
0
1954
1955
1956
1957
1958
1959
1960
*% OF TOTAL CREDIT EXPANSION


9
TYPES OF BANK CREDIT SUPPLIED
$BILLIONS
+10
+5
0
-5
LOANS
EXCL. MORTGAGES
MORTGAGES
TAX-EXEMPT SEC.
U.S. GOVT. & AGENCY SEC.
180
140
100
1947-49=100
PRODUCTION
1952
'53
'54
'55
'56
'57
'58
'59
'60

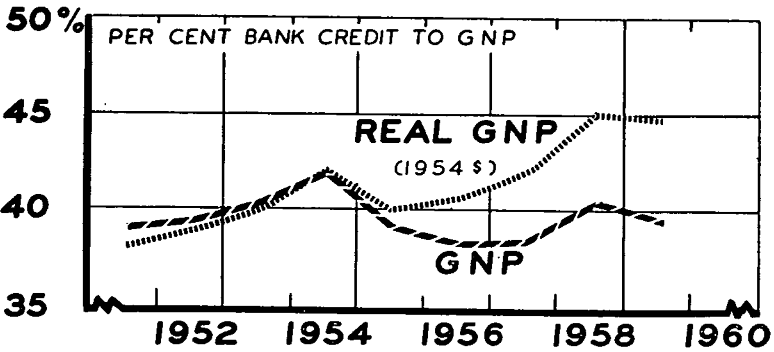
(10)

LOAN RATIOS OF COMMERCIAL BANKS

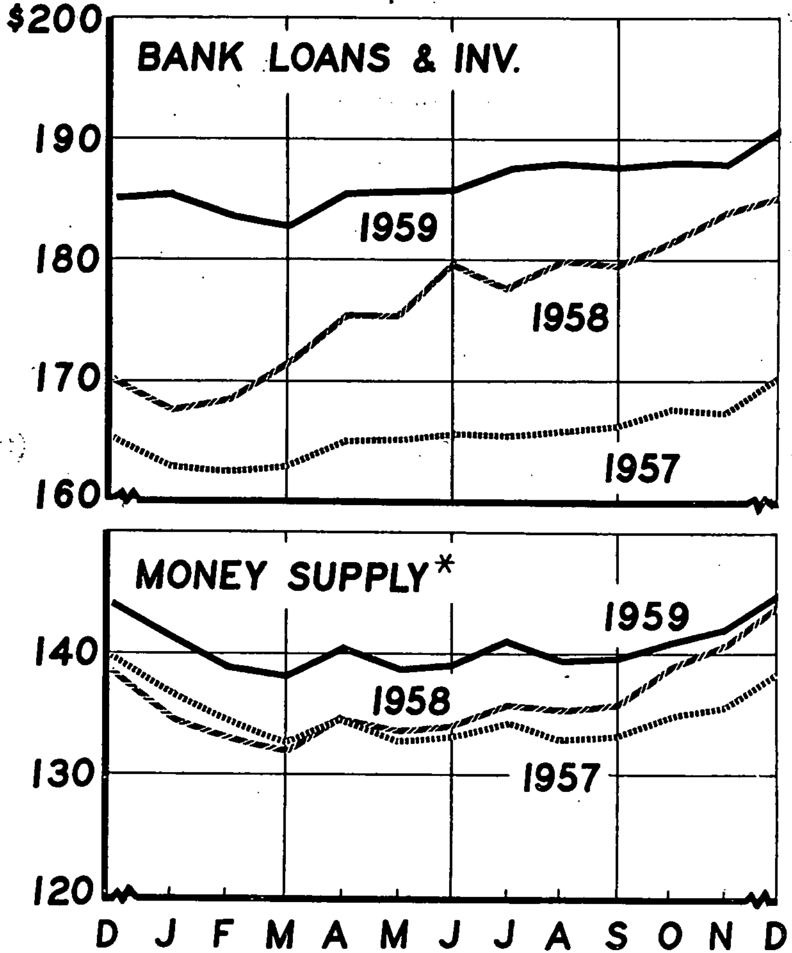




11
BANK CREDIT & GNP
$BILLIONS
600
500
400
300
200
100
END OF YEAR
GNP
REAL GNP
(1954 $)
BANK LOANS & INVESTMENTS
RATIO SCALE

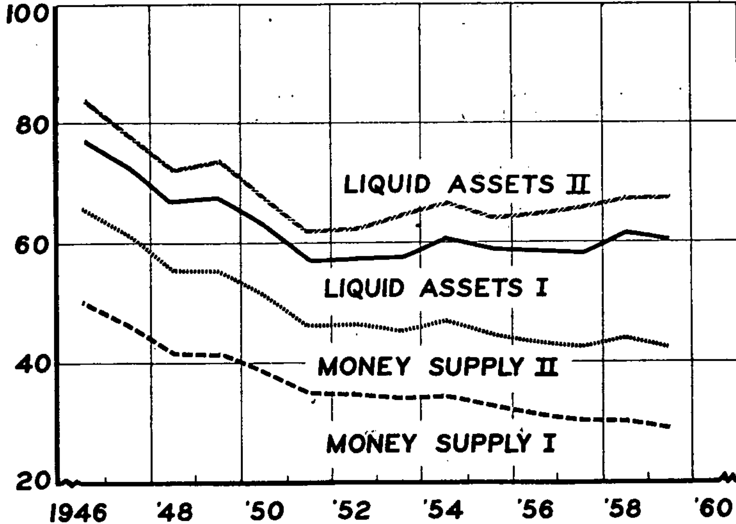


50%
45
40
35
PER CENT BANK CREDIT TO GNP
REAL GNP
(1954 $)
GNP
1952
1954
1956
1958
1960


12
BANK CREDIT AND THE MONEY SUPPLY
BILLIONS
$200
BANK LOANS & INV.
190
180
170
160
1959
1958
1957
MONEY SUPPLY*
140
130
120
1959
1958
1957
D J F M A M J J A S O N D
*DEMAND DEPOSITS & CURRENCY OUTSIDE BANKS

MONEY SUPPLY AND LIQUID ASSETS TO GNP* (13)

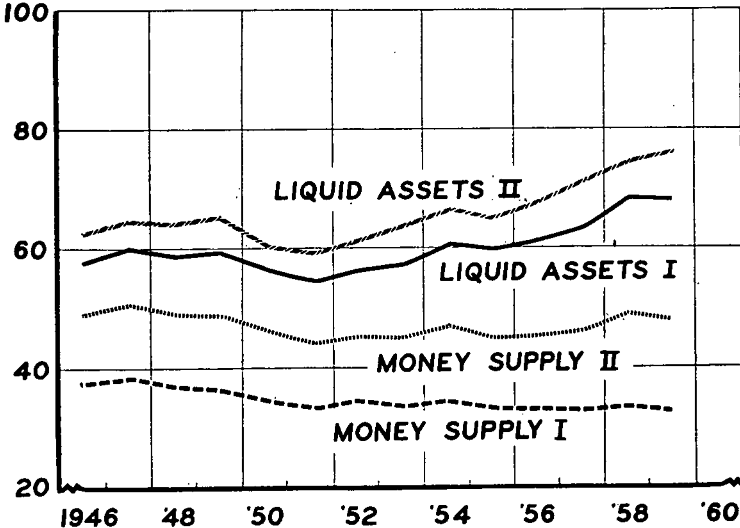
PER CENT



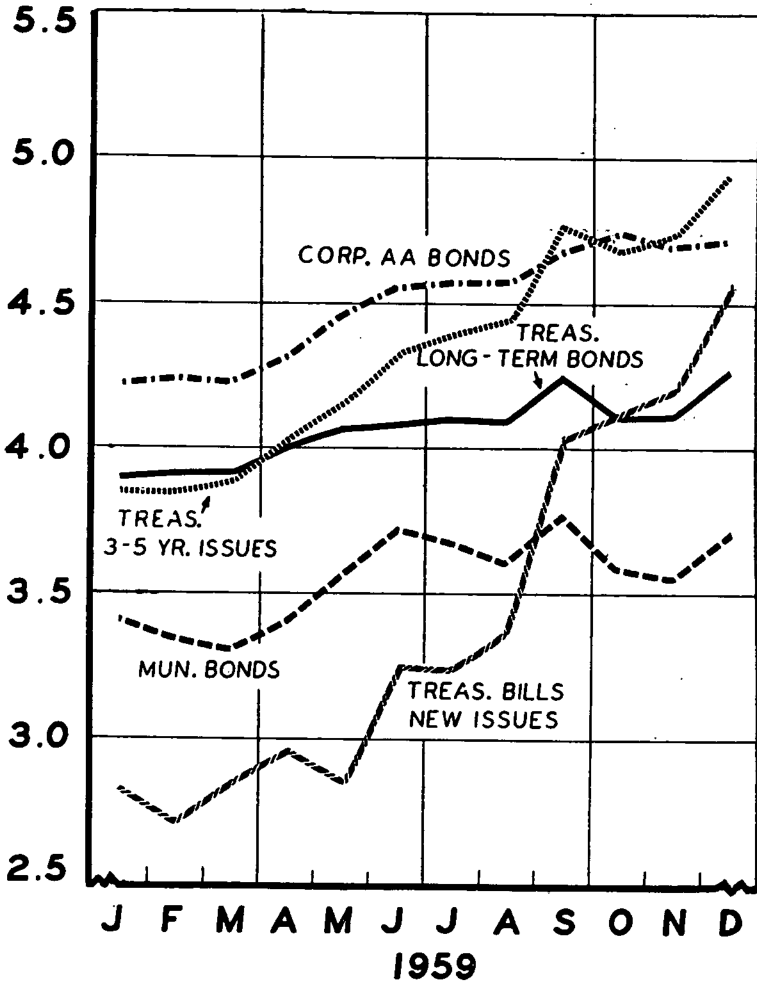
*MONEY SUPPLY I (DEM. DEP. ADJ. & CURRENCY OUTSIDE BANKS)
MONEY SUPPLY II (ALSO INCL. TIME DEP. OF COMM. BANKS)
LIQUID ASSETS I (ALSO INCL. MUT. SVGS. BANKS DEP. & SVGS. & LOAN SHARES)
LIQUID ASSETS II (ALSO INCL. 1-YEAR MKTBLE. TREAS. SEC. OUTSIDE BANKS & FOR. INVEST.)

MONEY SUPPLY & LIQUID ASSETS TO REAL GNP* (14)

PER CENT



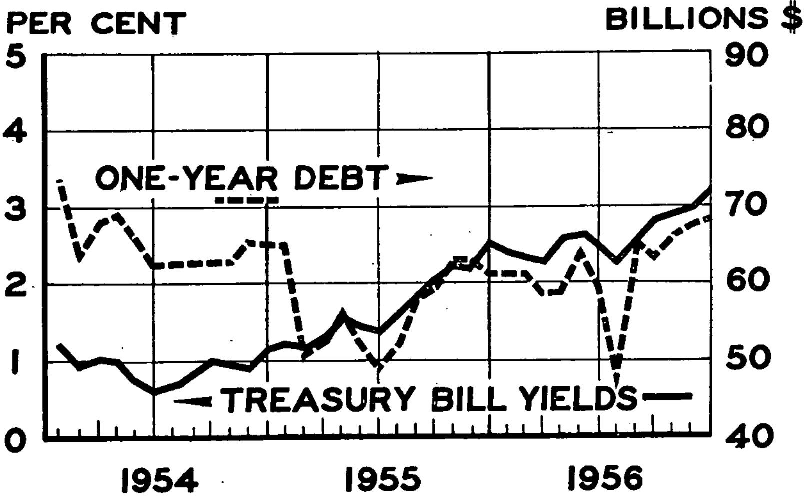
*MONEY SUPPLY I (DEM. DEP. ADJ. & CURRENCY OUTSIDE BANKS)
MONEY SUPPLY II (ALSO INCL. TIME DEP. OF COMM. BANKS)
LIQUID ASSETS I (ALSO INCL. MUT. SVGS. BANKS DEP. & SVGS. & LOAN SHARES)
LIQUID ASSETS II (ALSO INCL. 1-YEAR MKTBLE. TREAS. SEC. OUTSIDE BANKS & FOR. INVEST.)

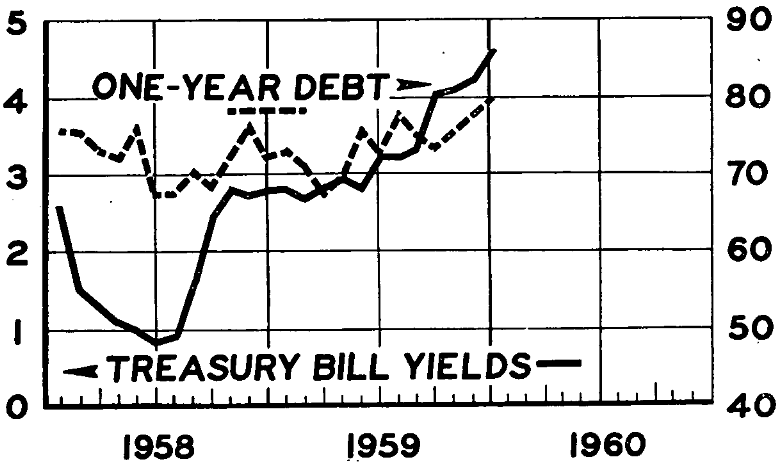


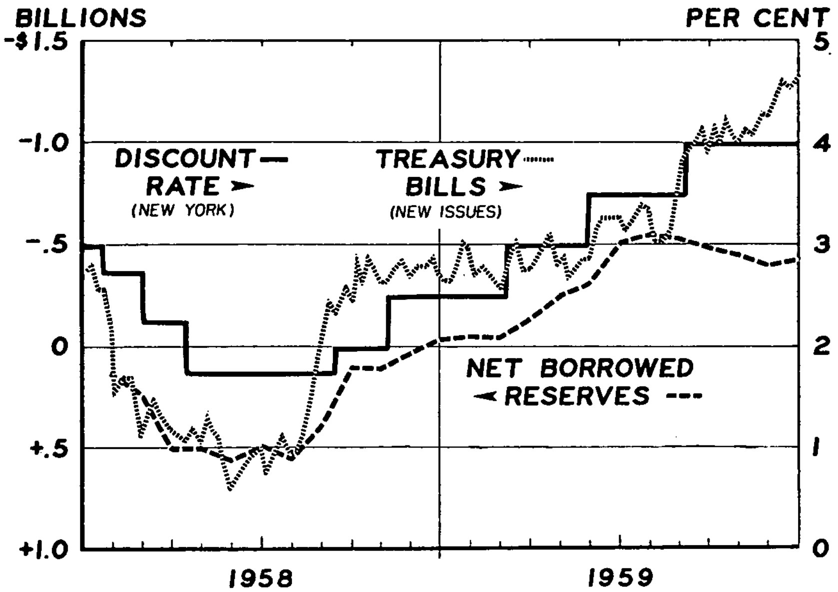
15
BEHAVIOR OF MARKET YIELDS
PER CENT
5.5
5.0
4.5
4.0
3.5
3.0
2.5
CORP. AA BONDS
TREAS.
LONG-TERM BONDS
TREAS.
3-5 YR. ISSUES
MUN. BONDS
TREAS. BILLS
NEW ISSUES
J F M A M J J A S O N D
1959

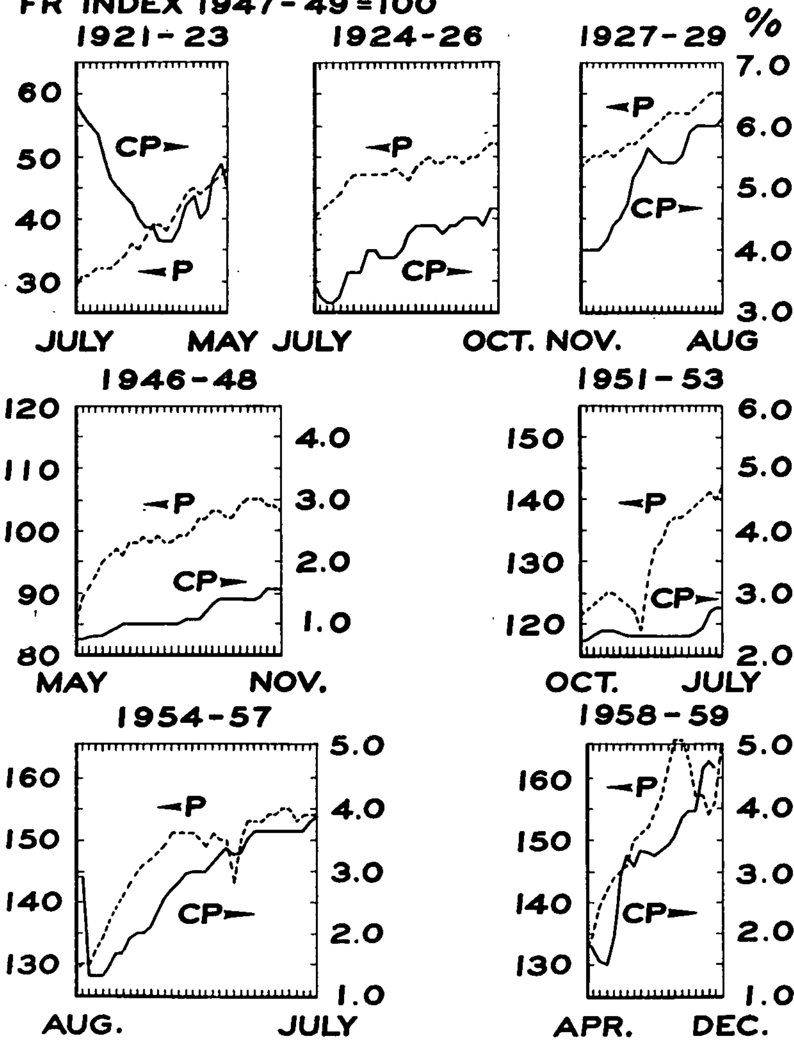
(16)

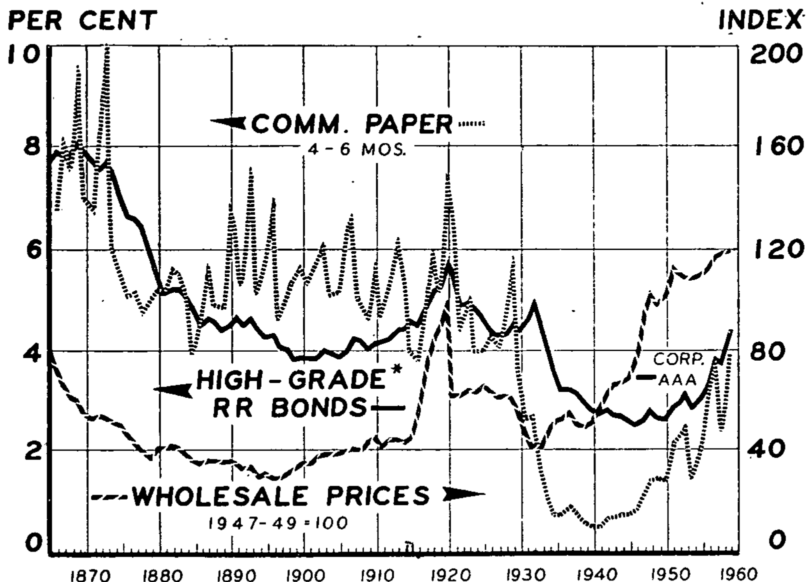
ONE-YEAR MARKETABLE TREASURY DEBT AND TREASURY BILL YIELDS

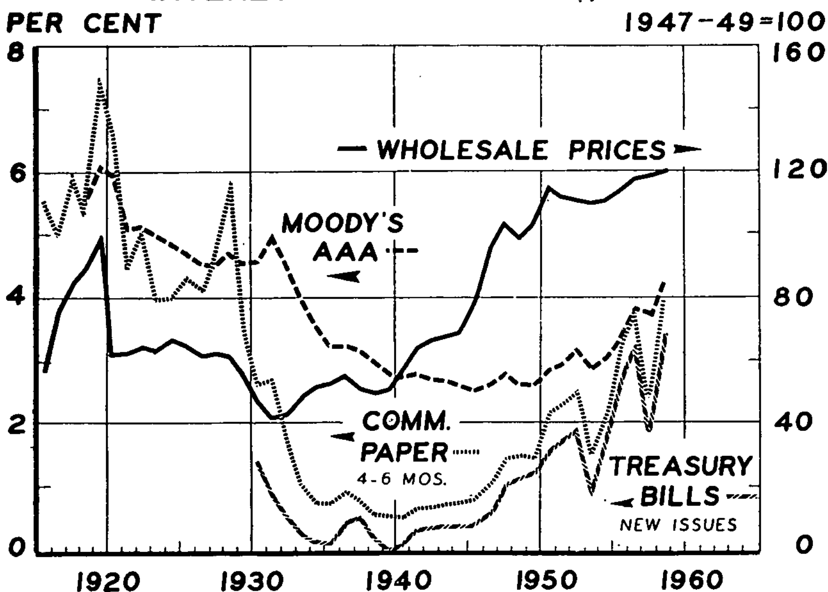





17
NET BORROWED RESERVES AND INTEREST RATES
BILLIONS
PER CENT
-$1.5
-1.0
-.5
0
+.5
+1.0
5
4
3
2
1
0
DISCOUNT RATE (NEW YORK)
TREASURY BILLS (NEW ISSUES)
NET BORROWED RESERVES
1958
1959

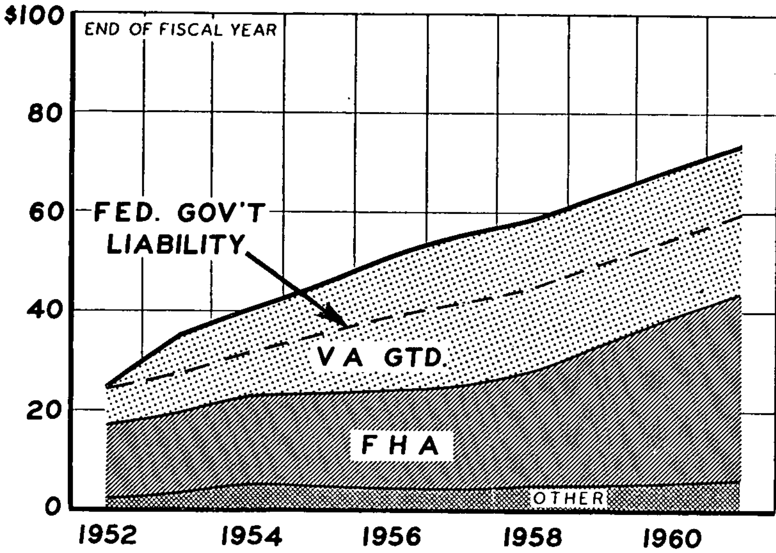

18
INTEREST RATES AND PRODUCTION
DURING UPTURNS
FR INDEX 1947-49=100
%
1921-23
1924-26
1927-29
60
50
40
30
7.0
6.0
5.0
4.0
3.0
CP
P
JULY
MAY
JULY
OCT.
NOV.
AUG
1946-48
1951-53
120
110
100
90
80
4.0
3.0
2.0
1.0
150
140
130
120
6.0
5.0
4.0
3.0
2.0
MAY
NOV.
OCT.
JULY
1954-57
1958-59
160
150
140
130
5.0
4.0
3.0
2.0
1.0
AUG.
JULY
APR.
DEC.
P=PRODUCTION, CP=COMMERCIAL PAPER


19
TRENDS IN PRICES AND INTEREST RATES
PER CENT
INDEX
10
8
6
4
2
0
200
160
120
80
40
0
COMM. PAPER
4-6 MOS.
HIGH-GRADE*
RR BONDS
CORP. AAA
WHOLESALE PRICES
1947-49=100
1870
1880
1890
1900
1910
1920
1930
1940
1950
1960
* NATIONAL BUREAU OF ECONOMIC RESEARCH


20
INTEREST RATES AND PRICES
PER CENT
1947-49=100
8
6
4
2
0
160
120
80
40
0
WHOLESALE PRICES
MOODY'S AAA
COMM. PAPER
4-6 MOS.
TREASURY BILLS
NEW ISSUES
1920
1930
1940
1950
1960

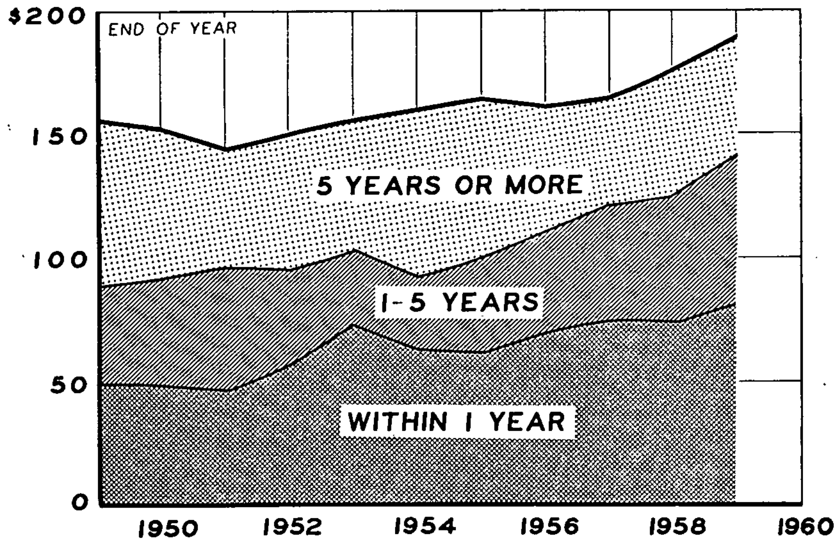
(21)

LOANS WITH FEDERAL GUARANTEES OR INSURANCE



(22)

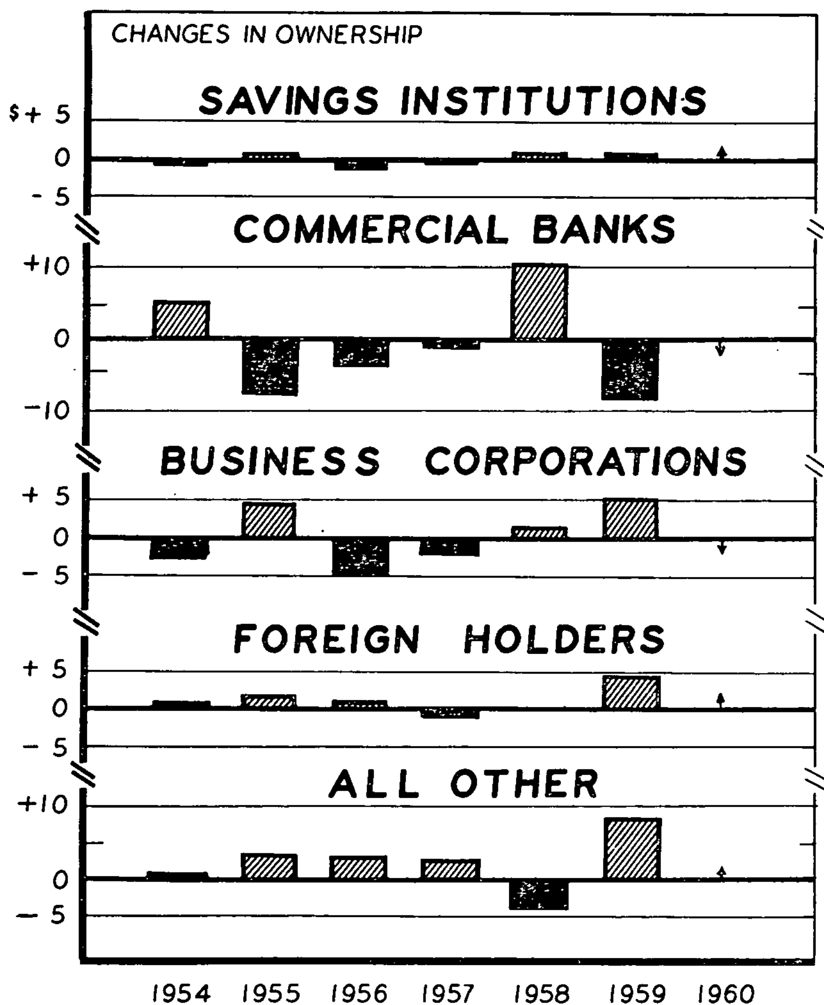
MATURITY OF MARKETABLE TREASURY DEBT

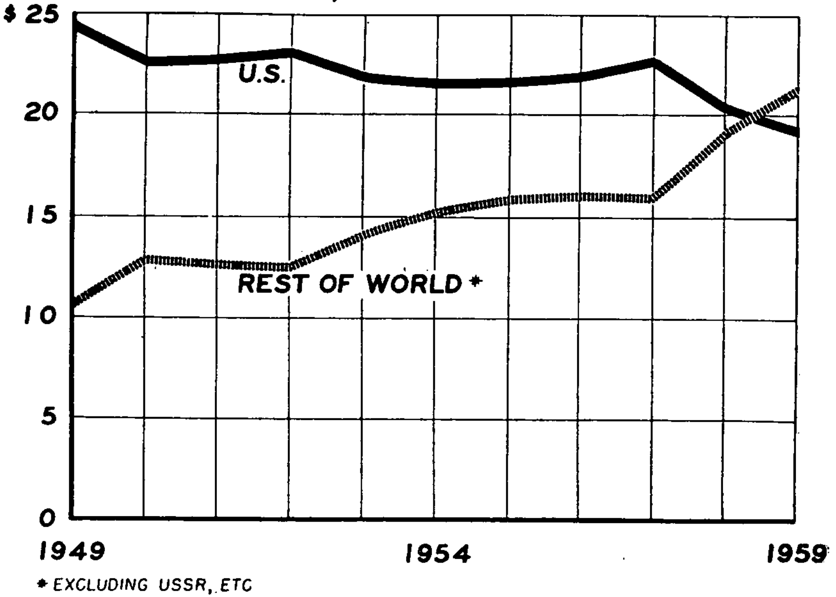


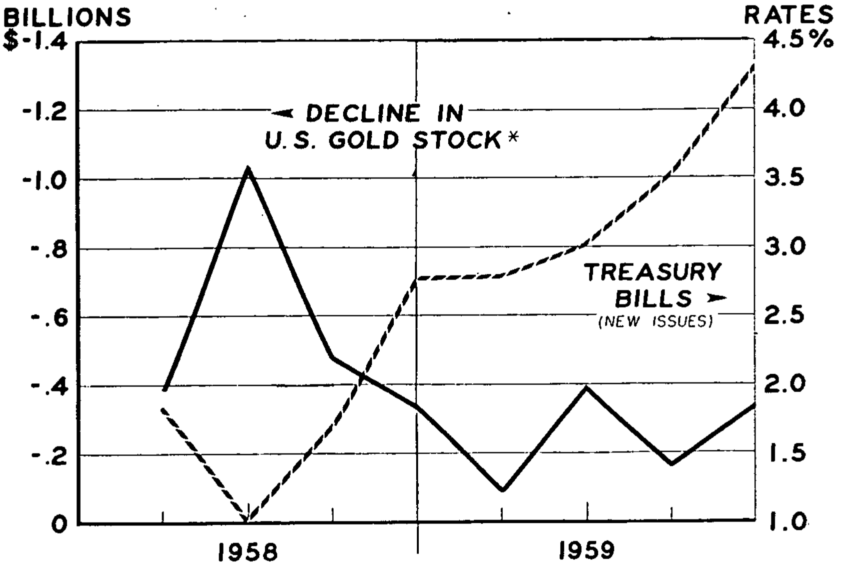
23

U.S. GOVERNMENT AND AGENCY DEBT HELD

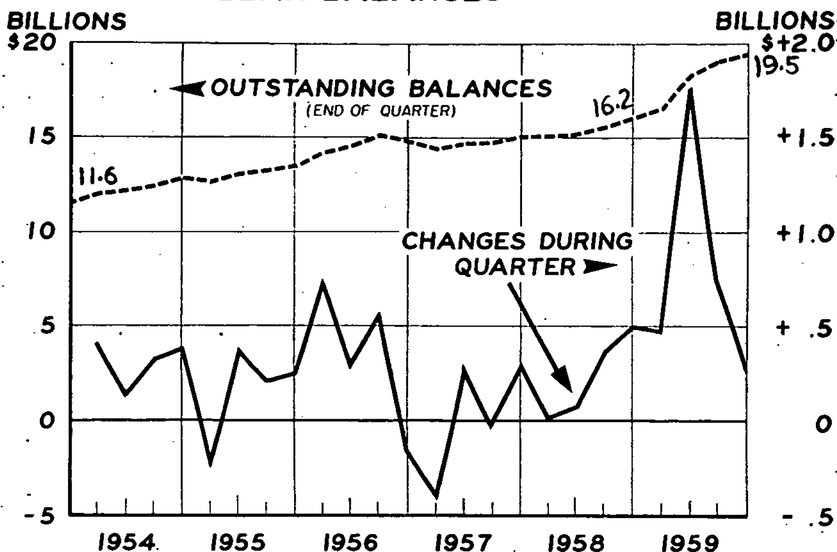
BILLIONS




24
GOLD RESERVES - U.S. VS. REST OF WORLD
BILLIONS (END OF YEAR)
$ 25
20
15
10
5
0
U.S.
REST OF WORLD *
1949
1954
1959
* EXCLUDING USSR, ETC


25
GOLD MOVEMENTS VS. TREASURY BILL RATES
BILLIONS
$-1.4
-1.2
-1.0
-.8
-.6
-.4
-.2
0
RATES
4.5%
4.0
3.5
3.0
2.5
2.0
1.5
1.0
DECLINE IN U.S. GOLD STOCK *
TREASURY BILLS
(NEW ISSUES)
1958
1959
* EXCLUSIVE OF TRANSACTIONS WITH IMF

(26)



The CHAIRMAN. The questioning will be begun by Congressman Patman.

Representative PATMAN. Mr. Reierson, I am glad you brought out the gold problem. You had a very interesting article recently, in which you advocated abolishing the 25-percent gold reserve requirement now, Am I correct in that?

Mr. REIERSON. That is correct. I suggested we reduce or possibly abolish this requirement.

Representative PATMAN. Well, I can see many reasons for your proposal. I am not so sure that I would be too much in disagreement with it under certain conditions.

When the Federal Reserve Act was created, was it not the fact that it was contemplated that people all over the Nation would have the same rates; that people in the East would have to pay the same as in the West, and vice versa; that the Federal Reserve System, in using the credit of the Nation, would do it in the people's interest and there would be very little difference in the rate structure? Is that right?

Mr. REIERSON. I would take your word for it, Mr. Patman. I do not know.

Representative PATMAN. Well, I will get down to the question I would really like to ask you. What is the conventional rate on housing in New York now? About 5 percent?

Mr. REIERSON. The Bankers Trust Co. is not an active mortgage lender. I am really not prepared to speak.

Representative PATMAN. I thought you were so well versed in matters of this kind you would know what the conventional rate was. Does someone else on the panel know?

Mr. SMITH. On mortgages, sir?

Representative PATMAN. Yes, sir.

Mr. SMITH. It is running 5½ to 6 percent.

Representative PATMAN. The rate in California is 7.2. Can you tell me any reason why the rate should be 7.2 in California, on the west coast, or in the Southwest, or any other place, and only 5½ to 6 in New England and New York?

Mr. REIERSON. Because the west coast is running a deficit of savings relative to mortgage demand and the east coast is running a surplus of savings relative to mortgage demand.

Representative PATMAN. In connection with the gold question, there is one argument that I have not noticed in the papers that I have been reading, about why it is unlikely that there will be such a large gold outflow. And that is that in order for people in foreign countries to withdraw their gold, or, at least, central banks to withdraw their gold, they would have to pay back the Federal Reserve notes that they receive for that gold, would they not?

Mr. REIERSON. Well, I believe what happens is that if foreign holders of dollar assets wish to convert into another currency, they offer the dollars for sale in foreign markets.

Representative PATMAN. That is right.

Mr. REIERSON. The discount on the dollar deepens. The gold price in the London market increases above——

Representative PATMAN. That is somewhat beyond what I am inquiring about.

What I am asking about is: When a foreign bank, for instance, sells a million dollars' worth of gold here in this country, the bank gets a million dollars in Federal Reserve notes, or the equivalent of a million dollars in Federal Reserve notes.

That is correct, is it not?

Mr. REIERSON. I do not think they take Federal Reserve notes. They take bank deposits.

Representative PATMAN. Or the equivalent. It is the equivalent of Federal Reserve notes, is it not?

Mr. REIERSON. I do not think so.

Representative PATMAN. They could get Federal Reserve notes, could they not?

Mr. REIERSON. I imagine they could, but they would not want them.

Representative PATMAN. Now, they put these Federal Reserve notes to work. They buy Treasury bills and they get interest. These notes are earning assests. But gold is not an earning asset, is it?

Mr. REIERSON. That is correct.

Representative PATMAN. So it is not very likely that foreigners would be too anxious to pay their money back and get their gold, when the money is being put to use, and a very profitable use now, but when the gold would not be productive at all, is it? Unless there is some unusual reason for it that does not exist now?

Mr. REIERSON. What happens is that if the returns available in foreign markets are greater, the funds will be withdrawn and put to work in foreign markets, on which they will earn a return.

Representative PATMAN. Now you are not advocating raising interest rates to keep an outflow of gold, are you?

Mr. REIERSON. I am not advocating it. I am saying that our present situation is such that this is one of the factors to which the Fed-

eral Reserve will have to give attention for the first time in a great many years.

Representative PATMAN. Is it not a fact, too, Mr. Reierson, in support of your argument that we do not need gold to support our money, that as long as our money is good for the payment of debts and taxes, I mean by law that a person is required to accept it in payment of debts and taxes, and as long as the debts and taxes are as high as they are now and are likely to be for a very long time, there is no likelihood of our money depreciating in value anyway, just for that one reason?

Mr. REIERSON. I could not disagree more, Mr. Patman. That situation has prevailed for a great many years, during which the purchasing power of the dollar has been cut in half.

Representative PATMAN. Well, that is on account of different factors.

Mr. REIERSON. Yes.

Representative PATMAN. But that still does not make your money worth less for the purpose for which it is intended, and that is for the payment of debts and taxes. There are some debts you can pay now with the same kind of a dollar that used to be, and some prices that have not increased.

Mr. REIERSON. Very few.

Representative PATMAN. Well, I know there are very few, but there are prices that have not increased. So the dollar has not eroded for all purposes.

I think the rate of interest that has been discussed is alarmingly high, myself, and I would just like to ask Mr. Gainsbrugh one question.

You have a very rosy prediction for 1960. Would you change your prediction if we should have a substantial increase in the interest rates?

Mr. GAINSBRUGH. No, I would not. I do not believe that a rise in interest rates would inhibit the type of growth that I have been describing. So far as investment in plant and equipment is concerned, the dominating factor is not the rate of interest; rather, it is the anticipated profitability of the investment that is the determinate.

Representative PATMAN. From the standpoint of the consumer, of course, the more that you divert by payment of interest, the less the consumer has to purchase goods and services.

Mr. GAINSBRUGH. Before you leave that, I would like to emphasize another point, if I may, Congressman. That is, that there are two sides to the interest rate—one is the cost side, and the other is the inducement side. And I would not ignore, so far as consumers are concerned, the possibility of inducing a higher rate of savings via the interest rate mechanism. This has been demonstrated recently in Britain.

Representative PATMAN. Of course, I do not agree that the interest rate induces a higher rate of savings. I have not been convinced of that. And to that extent, I disagree with you. I know that you have more information on the subject than I have, and people would normally accept what you say about it. But from the information that I have, I do not agree with that one statement.

Now, Mr. Reierson, I would like to ask you a question about interest rates. You know, we have always wanted to tie interest rates to something. And I do not think the market right now is a free market. I know there is a difference of opinion about this, but I share the views of people who do not believe that we have a free market in money in our country today, but there is a rapidly developing market that is a free market. That is a market on 91-day bills. The public is coming to the purchase of those bills, more every week, I believe.

Is there some way to tie the bank rate to the discount rate, the Federal Reserve discount rate, and then tie the discount rate to the rate on 91-day bills, which is a real competitive rate? Would you look with favor on consideration of a proposal that would probably lead in that direction?

Mr. REIERSON. As you know, Mr. Patman, the discount rate in Canada is tied to the current bill rate. And in Britain, the lending rate of the banks is tied to the rate of the Bank of England.

Representative PATMAN. I did not hear that.

Mr. REIERSON. In Britain the lending rates, I believe, are tied to the rate of the Bank of England.

Representative PATMAN. You mean the bank lending rate. In other words, the rate that is charged the customer by the banks?

Mr. REIERSON. That is correct.

Representative PATMAN. Is tied to the discount rate of the Bank of England?

Mr. REIERSON. That is correct.

Representative PATMAN. All right. Now then, in Canada, you say that the discount rate is tied to the Treasury bill rate?

Mr. REIERSON. That is my understanding.

Representative PATMAN. Well, by putting the two together, merging them, we ought to have a pretty good system to consider, ought we not? Because we have never had—that is my view, and I know it is disputed—a free market in money rates in this country. We do not have it today. That is the way I see it. I think it is more of a fixed market.

But we have one market that is developing as a free market, and that is the market in 91-day bills. I think it is going to be used more and more every week as the public becomes aware of it. And they are. And I think we can have confidence in it as being a real free market.

And since we know it is a free market, would it not be a good thing to tie our interest rates to it in the fashion that I have suggested we give consideration to?

Mr. REIERSON. The Treasury bill rate is a very volatile rate. It goes up and down from day to day.

Representative PATMAN. It is a competitive market, though, Mr. Reierson.

Mr. REIERSON. Yes, it is a highly competitive, highly volatile rate. I am not yet convinced that we would achieve much if anything by tying the discount rate to the Treasury bill rate. The chart that I presented earlier shows that there has been a relationship. But in recent months, for example, I would point out that if the discount rate had been tied to the Treasury bill yield, the discount rate would

have increased significantly in the past few months, during which time the Treasury bill yield has gone up very sharply.

Representative PATMAN. It has gone down in the last week or two, has it not?

Mr. REIERSON. That is right. It goes up, and it goes down.

Representative PATMAN. That is what I say. It goes up and goes down. That shows it is competitive. It is about the only really competitive rate that I know of that we have in our economy.

Mr. REIERSON. I think the considerations that underlie the change in the discount rate should include the behavior of the Treasury bill rate, but that there should not be any automatic tie of one to the other. There may be conditions, such as prevailed in the second half of last year, when the Treasury bill rate may show a very significant increase, and yet, for reasons that it thought sufficient, the Federal Reserve did not raise the discount rate.

Representative PATMAN. We could use an average over a period of time, could we not, Mr. Reierson, and get away from at least one of your arguments?

Mr. REIERSON. The trouble with an average is that it is not responsive to conditions in the markets at the time. And I think you would then lose the very thing you are trying to get on the other hand, which is the responsiveness of the discount rate to changes in the bill rate.

Representative PATMAN. Has the system in England worked well, and has the system in Canada worked well?

Mr. REIERSON. As to the system in Canada, I have not explored the reaction of the people in the financial markets. I do not know.

Representative PATMAN. You would be willing to study this, though, and give consideration to it, would you not?

Mr. REIERSON. Mr. Patman, I am willing to study anything.

Representative PATMAN. On the gold question again, I cannot see any good reason why we should have our money based on gold now at all, since it is really based on its use for the payment of debt and taxes. To that extent I suspect that I would be in agreement with you. On the matter of deficit financing, I do not see how we can ever get out of debt as long as the Federal Government pays its debts and then does not cancel them, and then puts the debt back in the hands of the commercial banks, who buy it for nothing and make the people pay the debts again. How will you ever get out of debt that way?

The Federal Reserve banks through open market operations hold $27 billion worth of Government bonds. Those bonds have been paid for once. They have been paid for with Government money. If you had your mortgage on your home, if you had one, paid for with your funds, you would expect that mortgage to be canceled.

I think Uncle Sam has the right to expect his obligations to be canceled in the same way when Uncle Sam's money is used to pay Uncle Sam's debts.

I am not in favor of canceling all that $27 billion. I am in favor of the Federal Reserve having enough to operate on for the purposes they expect to operate on. But $15 billion of it certainly could be canceled right now, because it has been paid.

I know we do not have time to discuss that now, but since you are coming back this afternoon we will have time to go into it then.

The CHAIRMAN. Congressman Curtis?

Representative CURTIS. Inasmuch as all the panel is going to return except Mr. Gainsbrugh, I think I would like to develop some questions of him.

First, let me add my appreciation to the panel for what I have regarded as an excellent discussion, I think one of the best that we have had.

Mr. Gainsbrugh, what I want to come into, if I can, is the limitations of the tools that we presently have to measure this question of prospects for expenditures for inventories, plant, and equipment.

I think we are beginning to develop some real figures in the area, but it strikes me that it is still quite limited. Now, for example, McGraw Hill is—what is it? A thousand companies?

Mr. GAINSBRUGH. I do not think it is as much as that.

Representative CURTIS. What about McGraw Hill? What is that?

Mr. PARADISO. I think around 600.

Mr. GAINSBRUGH. A relatively small sample, compared with the sample used by the Department of Commerce.

Representative CURTIS. What does the Department of Commerce use?

Mr. PARADISO. We have a very large sample running around 8,000 to 10,000 covering manufacturing and trade and other industries.

Representative CURTIS. And yours does cover manufacturing, trade, the service field?

Mr. PARADISO. All nonfarm industries.

Mr. GAINSBRUGH. All forms of activity.

Representative CURTIS. And also it attempts to sample large as well as medium and small?

Mr. GAINSBRUGH. One of the reasons for the size of their sample is that you have to have a larger sample of the smaller fund to have meaningful results.

Mr. PARADISO. The small companies are covered, but not to the extent that we would like. We do cover medium-sized firms and pretty much all of the large firms.

Representative CURTIS. The thing that has impressed me, in watching the cost of living index, is, of course, the constant rise in the service field; and it strikes me probably in the distributive field, as opposed to manufacturing. And it is also striking to me that it is in the distributive field and the service field that small businesses tend to dominate. I wonder if you would comment on how well your samplings might hit those particular areas.

Mr. PARADISO. We have made an attempt to get a stratified sample in this small company area, but I want to be very frank. I do not think we have what you might call adequate coverage in this small company group. One reason is that the investment total for these small firms is rather small and, therefore, we would not be getting too much pay dirt by putting a great deal more of our resources in that area. We recognize the utility of getting information for these small firms. But from the point of view of getting aggregate expenditures, we are able to do a very adequate job by canvassing the large firms, a good sample of the medium-sized firms, and some sampling of the small firms.

Representative CURTIS. That is why I directed our attention to this area, because I am concerned about aggregates. And in the service fields, for example, I use the word "dominate"—I do not know what the percentages are, but the amount of participation by the small concerns in that area is rather overwhelming, I think.

Mr. GAINSBRUGH. It is. But when you get to the absolute figures of total capital investment, investment in plant and investment in equipment, by the time you have accounted for in our instance the thousand largest manufacturing corporations, you have accounted for 75 percent of the overall total for all manufacturing capital outlays.

In addition to that, you have accounted for the volatile component; as goes the large 75 percent, so goes the remaining 20 or 25 percent. The sources of supply, the satellites, follow the expansion patterns of the large companies.

Representative CURTIS. That is exactly what I wanted to get out, for my own thinking. With manufacturing, you say, you probably are dealing with about 75 to 80 percent.

Mr. GAINSBRUGH. That is right.

Representative CURTIS. That is why I was directing my attention to the service and distributive field, to see whether or not we would be meeting a similar thing; again emphasizing that it is in this area that we have had this continued price rise in the service and distributive fields.

Mr. PARADISO. I might make this comment: The service and trade areas, which are dominated by the unincorporated businesses and small firms, in aggregate, as Mr. Gainsbrugh has indicated, do not contribute a great deal to the total.

Representative CURTIS. Let us stop on that. In relation to manufacturing, in other words, I appreciate it would be much smaller. Coud you give me a rough idea of what the amounts of investment would be in the distributive and service fields, for example, in relation to manufacturing? Are we talking about an 80–20 or 70–30?

Mr. PARADISO. These comprised about one-fourth of the combined manufacturing, trade, and service investment total in 1957.

Mr. GAINSBRUGH. The large areas of investment without question are in manufacturing and in the public utilities areas. In fact, if you look at Economic Indicators, you will get a pretty good idea from page 10 where the concentrations fall. And it is those areas in which the expenditures are not only large, but also these are the areas in which the investment patterns are most volatile. So we have concentrated our resources by trying to foreshadow as best we could what is going to happen in the most significant areas of investment.

There are some areas of investment that follow business activity or lag—for example, public utilities. There are other areas of investment that lead or are independent—for example manufacturing. It is the highly sensitive independent areas that we keep examining intensively.

Representative CURTIS. May I ask one question on this? Naturally, on one is ever satisfied with the development of our statistics. What is being developed presently to get these samplings more accurately? Just simply expanding it? Or have you got any ideas of other methods of checking?

Mr. PARADISO. Not other methods, but we are trying to get more adequate representation in more detailed industries. In other words, it is an expansion of a sample through covering various other industries not now adequately covered. And that is primarily the way it has gone.

Now, there is another development, namely, that instead of getting company figures, we are trying to get a breakdown of the company data into divisions or subgroups, so as to get at some product classification. Not quite that, but we would like to get closer to a product classification.

This is a development that is now going on intensively in the Bureau of the Census, particularly in connection with gathering information on inventories and sales and new orders; to get the company figures broken down into divisions, so that we can get better classifications and better allocations of these aggregate totals.[1]

Representative CURTIS. The reason I am directing attention to this area is that it is my judgment at any rate that this is the area of growth. This is where our new growth comes from. And as a matter of fact, in some respects, in the field of services and distribution, a new company is in itself research and development. It is testing out a new economic idea.

And so I come to my second line of questioning, or rather point. And Mr. Reierson comes into this one, I believe.

I noticed in the breakdown of how we are going to finance all this expansion there was not much distinction or separation of new equity investment. Corporate securities were mentioned, but not a breakdown of whether they were bonds or equity.

And Mr. Gainsbrugh, you felt that credit would not be a problem. But I am wondering if credit is not going to be a problem in this area, the growth area, as I have described it, where, it seems to me, most of their financing comes from new equity investment. As best they can, of course, they plow back, but it is more new equity investment.

I wonder if you would comment on that.

Mr. GAINSBRUGH. My figures related to the thousand manufacturing largest companies; and I think their retained earnings coupled with earned depreciation will provide the necessary cash flow. I think in the case of the smaller companies in the service and related areas Roy Reierson's figures may be more pertinent.

I do not have in mind the figures you offered in the way of a breakout of equities versus bonds, Mr. Reierson.

Representative CURTIS. I notice in your charts when you were pointing out only 20 percent of corporate bonds and stock in World War II, but it was not broken down into what was stocks or new equities, in regard to bond, which of course is debt financing——

Mr. REIERSON. That is correct. We have an estimate for 1959 which shows a breakdown—but these are highly tentative, and this is the

[1] The answer to Congressman Curtis' question will not be forthcoming until a new set of benchmark data are made available on trade and distribution as well as some other sectors. This was the main recommendation of the Bureau of the Budget in its Statistical Evaluation Report No. 1, "An Appraisal of OBE–SEC Estimates of Plant and Equipment Expenditures, 1947–58." The present Commerce-SEC series is still based upon benchmark data for 1948. In the iterim much has happened, particularly in the areas stressed by Congressman Curtis. Past experience arising from other revised benchmark statistics suggests that revisions in this field might be substantial.

reason I did not put them into the record. Our guess is that for the corporate sector in 1959, the stock figure is about $2.2 billion and the bond and note figure about $4.2.

Now, admittedly, breaking the total into its components is treacherous business. I have tried, and I have been wrong in the past. All I can say is that we for 1960 have held the level of stock at about the same as in 1959. These are aggregates that of course do not cast much light upon the first problem that you posed, namely, the availability of equity funds for dynamic sectors in the economy.

Representative CURTIS. Now, the other point on that is on the credit supply for commercial banks—and I may be wrong on my hypothesis, and if I am, I would like to be corrected: It seemed to me in the last recession that a good bit of the cutback in the credit extended by commercial banks was in the small business sectors, where probably they should have been financing through equity and actually were doing it through bank borrowings, and the cutback came there; again emphasizing that it is a small area, perhaps, but if I am right, this is the area of real growth. How that is financed becomes important; and this question of tight money, if it is directed into the growth area, can be more significant than we think.

Mr. REIERSON. I do not have the data at hand, Mr. Curtis, but I believe—this is from recollection—that the decline in business loans in the 1958 recession was much sharper in the big city banks than it was in the smaller banks.

Representative CURTIS. So that would not bear out what I am suggesting?

Mr. REIERSON. No, it would be quite the opposite from what you are suggesting.

Representative CURTIS. It would be the opposite, yes.

Mr. REIERSON. This is a matter of fact, and it can be verified.

Mr. PARADISO. It does tie to the nature of the recession, which was concentrated in the durable goods sectors, in manufacturing.

Representative CURTIS. Yes. That is very true.

Then it is your judgment, Mr. Gainsbrugh, that credit will not be a problem in financing this expansion you see in inventory, plant, and equipment, even in the sector to which I have directed your attention?

Mr. GAINSBRUGH. I think it is more likely to be a problem in the sectors that you have spoken of than in the sectors that we are able to examine. But knowing the overall totals of corporate profits as they have emerged for the year 1959 and as they are shaping up for the year 1960, and looking at the enlarged depreciation base in 1960 as compared with 1959, I would say that industry is in a fairly good position in the aggregate to finance its expansion in 1960.

Representative CURTIS. Established industry?

Mr. GAINSBRUGH. In the aggregate.

Representative CURTIS. Yes. You see, your depreciation, of course, only applies to your established concerns. Your new and your growth of course gain very little from that until they are established.

Mr. REIERSON. Again, this does not relate to growth in growing versus stable industries, but I would like to point out that the deposit loan-asset ratio is lower, much lower, in the smaller banks, which bears on the size question.

Representative CURTIS. Yes. There were a number of questions I wanted to ask you on the charts, but I wanted to develop this area.

Representative REUSS. I would like to pursue with you Mr. Reierson, your recommendation, which I think is an appealing one, that Congress take steps to repeal the outmoded statutory reserve requirement of 25-percent gold coverage. I take it you would not recommend that unless you believed that that is a fairly fanciful item; that the gold coverage means whatever Congress says it means, and that we could get along perfectly well with a gold coverage not of 25 percent as at present, but of let us say 5 percent, or I gather you say even zero percent.

Mr. REIERSON. If in these other areas we do not do the thing we have to do, then the 25-percent reserve requirement is not going to save us from further trouble any more than it has saved us from a very substantial increase in prices in the past.

Representative REUSS. Yes; but conversely, if we do all the other things with monetary policy, fiscal policy, price policy, that you are talking about——

Mr. REIERSON. Shall we add prices and wages at the same time?

Representative REUSS. Yes; although I think you are disturbed, I take it, not at wages in and of themselves, but at wages insofar as they are reflected in prices.

Mr. REIERSON. They have an income effect as well as a cost effect, and I think the ratio between wages and prices is much more exact than my friend on the panel would necessarily agree with.

Representative REUSS. However, let us get back to the 25-percent coverage.

Mr. HENLE. I shall be happy to discuss the wage-price problem any time.

Representative REUSS. We will be happy to do that this afternoon.

Even if we do all these other things with the rest of the economy, which I hope we do, we still have a problem because of this outmoded archaic 25-percent gold coverage; do we not?

Mr. REIERSON. I believe so.

Representative REUSS. The arithmetic of the problem is something like the following, is it not: Our gold stock is down to around $19 billion. Short-term foreign held dollar credits are now around $19½ billion. If we keep the 25-percent gold coverage, that means that only around—you say $7½ billion—it is actually a little less than that?

Mr. REIERSON. Seven to seven and a half.

Representative REUSS. Is available to meet foreign withdrawals. And I guess your point is that if you have $19½ billion worth of credits and only $7½ billion in the till, this disparity, if accentuated in the future, could well cause some trouble.

Mr. REIERSON. Yes. I am fearful that the existence of the restriction will be in the future a disturbing factor that could mean more rather than less withdrawal of gold. That is true.

Representative REUSS. And would not that trouble be accentuated by the following factor: I notice on page III of your statement you say—

> A cardinal feature of the countercyclical aspect of credit policy is that bank reserves are provided liberally in a period of business recession.

And I think most people would agree with that.

If we sit tight and do nothing about this 25-percent gold requirement, are we not likely to get into a situation where credit needs to be eased, where interest rates need to be lowered, in order to permit economic expansion, but where we find ourselves unable to do it because we are afraid that foreign creditors will not want to accept a lower interest rate here and hence will want to flee from the dollar? Does that not exacerbate the problem?

Mr. REIERSON. Yes. I would agree that the very high level of foreign asset holdings introduces an element of future possible instability under the circumstances that you have described.

Representative REUSS. Would you agree that with respect to this 25-percent gold coverage, "if 'twere done, then 'twere well 'twere done quickly," and this year would be a particularly good year to do it, before the projections that you have made come to pass? That is to say, you have projected for 1960 that the imbalance is going to get worse, that we are going to lose more gold and foreigners are going to acquire more dollar credits in this country. Since what we are trying to guard against is a situation where the disparity between the amount of foreign credits and the amount of free gold in this country is so great that foreign creditors decide that they had better take it while the taking is good; since that is what we are trying to avoid, would it not be the part of wisdom to get ourselves in a more flexible position now by repealing or drastically modifying the 25-percent gold coverage law?

Mr. REIERSON. I am of that opinion.

Mr. GAINSBRUGH. I do not want my silence at this point to be interpreted as assent. I think you would find considerable difference of opinion within this panel on this point, particularly when you speak of its timing.

Representative REUSS. Will you spell out your views?

Mr. GAINSBRUGH. What we are witnessing is in a sense a serving of notice upon our economy that it must respect the disciplines of the wage-cost-price structure in international markets to a greater extent than in the past. These are some of the weaknesses which have contributed to the state in which we find ourselves currently.

What I am concerned about, in connection with at least this particular approach to solution of the problem, is that this may be interpreted as further signs of weakness in the American economy, rather than as a basis for a rebuilding of confidence in the strength of the American economy.

I think the things that we should be paying more attention to are our wages, our costs, our prices, the disciplines of the free market; yes, and even the disciplines of the gold standard, as they emerge now from an international sphere rather than domestically. These are things we have ignored for a long period of time. And I do not think we solve them by saying of a sudden, "We will eliminate our tie with gold."

Representative REUSS. If I may take Mr. Reierson's side of the argument, I think he has quite clearly said, on page 29, and he just said it again in answer to my question, that of course the fundamentals of our international trade position have to be observed. We have to stop domestic inflation. We have to review our foreign aid and trade policies. We have to get our trading partners to drop their

restrictions against American goods. And we have to get more competitive and efficient here.

But what we are talking about is: Having done all those things, or having set those things in train so that we are trying to do them, why should we continue to wear the quite irrelevant and unnecessary hair shirt of the 25 percent gold coverage? And maybe this afternoon—I see my time is up—you can address yourself to that.

Thank you, Mr. Chairman.

The CHAIRMAN. It has been a very interesting line of inquiry. We have given the other members of the committee 15 minutes rather than 10, so you can have five minutes more.

Representative REUSS. Do you care to come back at me?

Mr. GAINSBRUGH. Yes, I think we have worn that hair shirt for a long period of time, and I for one am reluctant to shed it until there is very good reason for discarding it. I do not believe the reasons that have been advanced are good reasons. They are primarily designed not to cure but to alleviate the situation. They deal with the surface manifestations, rather than with its causes.

I am also a little bit unhappy over what this might subsequently mean in terms of foreign appraisals of our action. I think action taken at this paricular period of time might very well be interpreted as indications of general inability to correct imbalance internally. Such a change might thereby intensify foreign suspicions of the true strength of our domestic economy and of our resolve to halt inflationary pressures rather than yield to them.

Representative REUSS. I hate to seem ungracious, but I have been sitting here for years and listening to witnesses, mainly Mr. Martin and Mr. Anderson, come here and tell us that in these times of relative prosperity we have got to boost interest rates and have tighter money, because the monetary masters of the world would go into a tailspin if we did not. Now what we are talking about is a time—I hope we do not reach it in the future—where by anyone's estimate we would need to have a more liberal credit policy and lower interest rates, because by our hypothesis, at this future time, we are going to have a less prosperous situation than we now have, something of a recession.

I just do not like to see ourselves get into a box where even then we cannot reduce interest rates and provide a greater supply of money and credit, because it will be said that foreigners will thus lose confidence in the dollar if we do it.

It seems to me that at some point in the cycle we ought to have lower interest rates. I would like to see us have lower interest rates at all points in the cycle. But I would hate to see it now erected into a canon that we cannot ever have lower interest rates because if we do foreigners will sell their American holdings and withdraw.

Mr. GAINSBRUGH. I would not accept the thesis that the argument I have been advancing indicates that interest rates would not be corrected in a period of contraction. I think other policies, however, would be pursued by the Federal Reserve, such as a lowering of reserves at that period if that became necessary. There are other tools beyond those available to the Fed, for example, changes in our mutual economic aid, in our military expenditures abroad, and so forth.

Representative REUSS. But if it meant anything, they would cause lower interest rates. That is the point of easy money, in my book.

And when that happens, owing foreigners not merely $19½ billion of short-term American credits, but whatever the larger future sum happens to be, they are going to say, "Well, I can make more money in Turkey or Tangiers, so give me my gold. I am off."

It would be a good idea, Mr. Reierson, and—think, not to be in so vulnerable a position then. It would be a much better idea if we could then shrug our shoulders and say, "Take your gold. Go where you want. Your taking it is not going to cause a domestic American crisis."

Mr. GAINSBRUGH. There is considerable strength in your argument at the moment, but I still would prefer the use of other devices to restore a favorable balance of payments.

Representative REUSS. Are there any other comments on this point? Are there any other dissenters from the Reierson thesis?

Mr. SMITH. I do not consider myself a monetary expert, but I do think Mr. Gainsbrugh has a point on foreign reaction here. It would seem to be a further weakening of our disciplines. I think that ought to be kept in mind.

Representative REUSS. Well, I am glad that we have here a very conservative, both-feet-on-the-ground banker with a great reputation, and associated with a very solid financial institution, who does not feel that he is advocating anything heretical here. This is a pleasure to me.

Mr. REIERSON. Thank you very much. I think you have made a very good presentation of my case, Mr. Reuss.

I do think, however, apropos of the point just made by Mr. Smith and also by Mr. Gainsbrugh, that obviously we must give attention to the foreign appraisal of our position. And this has implications for all these other policies.

Now if we were to contemplate changing the reserve requirement and decide to establish a 2½ percent maximum interest rate ceiling for U.S. Government bonds, then nothing we could do about reserve requirements would prevent a very serious deterioration in foreign sentiment.

Representative REUSS. The real question is, though: If you do all the things that you need to do, do you not still need to do something about the 25 percent requirement, or you may vitiate all the good you do by the other sound policies?

Mr. REIERSON. On that point we are in agreement.

Representative REUSS. Thank you, Mr. Chairman.

The CHAIRMAN. If I may turn to a more pedestrian and less exciting series of subjects: Do not most of the conclusions about growth rates and the predictions about governmental receipts depend upon what the estimates of gross national product would be? Now the Council of Economic Advisers and the Secretary of the Treasury have said that they estimate for 1960 a gross national product in terms of current dollars of $500 billion.

Mr. GAINSBRUGH. $510.

The CHAIRMAN. Is it $510? Pardon me, $510. Which would be a growth rate of around 6 percent, in terms of current dollars. It is not certain whether this includes an allowance for——

Mr. GAINSBRUGH. In current or 1960 dollars?

The CHAIRMAN. 1960 dollars. It is not certain that this includes an estimate of an increase in the price level, and we can only develop that when we question the Chairman of the Council tomorrow.

Now I know that you gentlemen have been treating specific sectors, and it is somewhat hard to piece together from these various sectors what your estimates are on the gross national product. I wondered if, however, you have overall estimates.

Mr. GAINSBRUGH. I would offer as mine the consensus of our conference board economic forum, of gross national product in dollars prevailing in 1960, of $510 to $520.

Mr. SMITH. Senator, I have a survey which we take each year, of leading economists in the country. We took it in late October. The median forecast of that group of 273 economists was for an annual rate of $514 by the fourth quarter, which would jibe with $510 or somewhere in that neighborhood for the year.

The CHAIRMAN. Anyone else?

Mr. HENLE. We have been going on the assumption that it will be somewhere in the neighborhood of $510.

The CHAIRMAN. What price levels do you assume?

Mr. SMITH. In our case, current prices.

The CHAIRMAN. That is November 1959 prices?

Mr. SMITH. No, current prices. That is, in current dollars.

The CHAIRMAN. You mean 1960 dollars?

Mr. SMITH. Yes, sir.

The CHAIRMAN. What about the relationship of 1960 prices to 1959 prices?

Mr. SMITH. This same group of economists felt that there would be a small increase in the indexes. They thought the consumer price index would be up to 127 by December. This was 2 percent above the level in mid-1959.

The CHAIRMAN. Is this the estimate of the increase in the general price level?

Mr. SMITH. In the consumer price index, yes.

Mr. GAINSBRUGH. One to one and a half percentage points; which is a little different.

The CHAIRMAN. That would be approximately 1 percent.

Mr. Gainsbrugh?

Mr. GAINSBRUGH. May I offer a comment in that connection—on the widespread stability of prices, as manifest in the President's Economic Report, page 23 and following? I would like to underscore the extent to which we have had price stability during the past 2 years.

The CHAIRMAN. This is sweet music to my ears, because I have been saying that we had price stability and were going to continue to have relative price stability during this past year, when there has been this terrific hullabaloo about inflation.

Mr. GAINSBRUGH. On page 198 of your Economic Report, you will find that the wholesale price index, as we ended December 1959, is exactly as high as it was in January of 1958.

The CHAIRMAN. Thank you again. And I only wish that you could influence the public relations statements of insurance companies, banks, business leaders, financial writers, and Treasury officials.

Mr. GAINSBRUGH. I would underscore that in still another fashion. I think the public still believes that the consumer price index has been

kiting up during the past year, as it did ever since the end of World War II, and that wholesale prices are also rising. The evidence is to the contrary. The consumer price index rose by only 1 percent of a point for the year 1959 compared with 1958.

The CHAIRMAN. I could not agree with you more. The illusions which have been created in the popular mind by this administration——

Representative CURTIS. Now, wait a minute.

The CHAIRMAN. Now, wait. I am talking. You cannot interject at this time—created by this administration, by the insurance companies, by the advertising which has been carried on, has introduced an element of hysteria into the popular mind which has not been borne out by facts. And I am very glad to have this testimony from Mr. Gainsbrugh that we have had an almost complete comparative price stability.

As I say, we can reduce the temperature now, a little bit.

Representative CURTIS. Would the Senator yield for just one point?

The CHAIRMAN. I will yield for one point, but not for a speech.

Representative CURTIS. No, this is not a speech.

Do you not think there is a distinction between what happened and what might happen? And do you not think inflation is a threat?

The CHAIRMAN. Even at the time the hullabaloo was going on, there was no increase in prices.

Mr. SMITH. Sir, may I stick my neck out a little bit in this? I do not quite agree with Mr. Gainsbrugh, because on page 25 of the President's statement there is a table which breaks down the changes in the wholesale price index. And it is quite obvious from this table that what we have had is a mixture which just happened to average out to be stability. If you look at the table, every single decrease on the table is in the farm and food area, and there have been some rather sharp increases in the other segments.

The CHAIRMAN. That is true.

Mr. SMITH. So on the average, we have no inflation, but we do have divergent trends that can distort the economy.

Mr. GAINSBRUGH. We have had divergent trends in the past in which the farm price index was the major villain of the piece and industrial prices were not.

The CHAIRMAN. You have to use some general price index as a measure of the purchasing power of the dollar.

Mr. HENLE. I would like to add one additional point, and that is that I think an increasing number of people are looking with some skepticism on the mechanics of the Consumer Price Index.

Mr. GAINSBRUGH. Hear! Hear!

Mr. HENLE. I think we are very fortunate to have a committee looking into this problem. And I would not be surprised if their conclusion was that the Consumer Price Index tends to overstate rises in prices.

The CHAIRMAN. Because it does not take into account the improvements in quality.

Mr. GAINSBRUGH. We introduce a compact car. That car will perform the service of transportation for less than the standard car. The introduction of the lower priced compact car does not, however, reduce the Consumer Price Index, since the Consumer Price Index is designed to measure price change rather than change in the abso-

lute levels of expenditures. Nevertheless, the consumer's original cost of transportation by car will decrease, as will maintenance costs.

The CHAIRMAN. What I am trying to get at is what the estimate is of the increase in the real national product—whether this estimate of 6 percent of increase in money value of gross national product should be discounted by the expected increase in the general price level. And I certainly would not accept the Consumer Price Index as an accurate measure of the price level for the gross national product.

Mr. GAINSBRUGH. It is not. We have for that purpose the implicit price index of the gross national product. And that reflects expenditure change as well as price change.

The CHAIRMAN. What I am trying to get at is this: Is this expected 6-percent increase a completely real increase or is it slightly higher than the real increase would be?

Mr. GAINSBRUGH. I would say possibly 1 percentage point.

Mr. PARADISO. It depends on whether you are talking about the $510 billion which the Secretary of the Treasury used in making a revenue estimate. I think you have to get the answer on the $510 which the President put in his budget message from the people who make up this number.

The CHAIRMAN. Well, what do you fellows estimate the price level to be?

Mr. PARADISO. I think there probably will be some very moderate price increase, possibly in the nature of this 1 percent that has been talked about around here, which would mean a 5-percent increase in real terms consistent with the $510 billion estimate.

The CHAIRMAN. You all seem to agree on $510 billion or possibly more.

Mr. HENLE. We have been using a 5 percent growth rate from 1959 to 1960 in real terms.

The CHAIRMAN. That is the only question I have.

We will recess until 2: 30.

(Whereupon, at 12: 30 p.m., the hearing was recessed, to reconvene at 2: 30 p. m. the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will be in order.

We have gone around once so I am going to ask Congressman Patman to continue.

Representative PATMAN. Thank you, Mr. Chairman.

As I understand it, Secretary Anderson cannot be here this afternoon but when he returns, he will be prepared to be a witness.

The CHAIRMAN. That is correct.

Representative PATMAN. Mr. Reierson, I want to ask you some more questions along the lines of the ones I asked you this morning. When the Federal Reserve bank—assume in New York—buys bonds for the Open Market Committee, what does it pay for those bonds?

Mr. REIERSON. It gives deposit credit.

Representative PATMAN. Conceding that it can get Federal Reserve notes if so minded?

Mr. REIERSON. Yes.

Representative PATMAN. So when the New York Bank buys, say, a million dollars worth of Government securities it in effect and for all practical purposes gives what is equivalent to money that is printed in Federal Reserve notes?

Mr. REIERSON. The deposits can be converted into Federal Reserve notes.

Representative PATMAN. That is right. As long as it is printed there is no gold behind it, is there? There is no gold behind Federal credit until the actual Federal Reserve note is issued, is that correct?

Mr. REIERSON. Or until the deposit liability is created. It applies to both.

Representative PATMAN. And the Federal Reserve notes are called for?

Mr. REIERSON. Or issued.

Representative PATMAN. As long as it is credit there is no gold reserve behind it?

Mr. REIERSON. The reserve requirement applies to outstanding Federal Reserve notes and deposit liabilities of the Federal Reserve banks. I think we are talking about the same thing.

Representative PATMAN. I think so too. In other words, there is a 25 percent gold reserve requirement in the form of gold certificates behind every dollar of Federal Reserve notes that are issued and outstanding. That gold is not behind the credit. Now, if that million dollars is bought by the Open Market Committee and is held there that credit is in the banking institution somewhere, that million dollars of credit?

Mr. REIERSON. Unless taken out in the form of Federal Reserve notes.

Representative PATMAN. How would it be taken out, Mr. Reierson?

Mr. REIERSON. If a person, holder of deposits decides to convert into Federal Reserve notes.

Representative PATMAN. Decides to convert it into Federal Reserve notes.

Mr. REIERSON. Convert deposits into Federal Reserve notes.

Representative PATMAN. Then automatically and immediately the gold requirement would come into discussion and the gold reserve in the form of gold certificates would have to be behind it because it had actually been issued?

Mr. REIERSON. Yes.

Representative PATMAN. Now then the Federal Reserve today holds about $27 billion of Government securities. I was over at the Federal Reserve Bank of New York about 25 or 30 years ago and they had a hundred and two people clipping coupons and they only had a billion or two dollars at that time. I was at the bank again last fall and I asked to go to the same room where the portfolio was. I went into the same large room but nobody was clipping coupons and they took me way back to the end to a safe about 36 inches square. I said I wanted to see the portfolio.

They said, "It is all in here." They opened it and there is a stack of bills about that high.

I said, "You do not mean to say there is $27 billion in that stack?"

And they said, "That is right."

I discovered automation had taken hold there which is a good thing and I am glad the Treasury is cooperating and there are no more people clipping these coupons. They had these bills in piles of $500,000 each. So instead of clipping thousands of coupons they would just clip, say, $1,275,000 from one bond. I am just bringing this up as of incidental interest.

The $27 billion was acquired by just the same process that you and I have discussed, they gave Federal Reserve credit for it, and for that Federal Reserve credit the recipients could also demand and receive Federal Reserve notes for it. But the point I am trying to make right now is as long as they do not call for these notes, these Federal Reserve notes, there is no gold behind them at all.

But when they call for the Federal Reserve note the gold automatically becomes obligated for it. And the Federal Reserve notes, as I understand it, are all issued not only on the credit of the Federal Reserve bank, they are issued on the credit of the U.S. Government, by another form of Government obligation. I have one here which says: Federal Reserve note, United States of America promise to pay to the bearer on demand blank dollars.

Now that is the same as a Government obligation that is interest bearing as far as the liability of the Government is concerned, is it not, Mr. Reierson? In other words, if that were a $20 bond that was drawing interest it would have the same kind of a promise to pay. The Federal Reserve banks are not promising to pay it. They make no promise at all. The money that is issued and the money that we use is represented by an obligation of the Government just exactly like a Government bond except it is not interest bearing, is that not correct?

Mr. Reierson. The interest-bearing feature is the all important difference between a Government security and currency.

Representative Patman. That is right. But it is a Government obligation though, is it not, a Federal Reserve note? It is a Government obligation. Now then the point I am trying to make is we hear a lot about balancing the budget and I am very much in favor of it. In fact, when times are good I would be willing to vote against adjournment of the Congress until the budget is balanced and we have made a substantial payment on the national debt. I have been associated with that view for years.

We could take this $27 billion over to the open market and cancel 15 billion of it on the correct and, I think, genuine theory that the Government has paid for it once and why should the Government pay for it twice. Here is what I base that on, and I hope you agree with me on this, when the Federal Reserve banks buy these $27 billion in bonds they issue $27 billion of credit of Uncle Sam. That is just the same as if you had a $27,000 mortgage on your home and you gave a check on your own funds to pay that mortgage and you sent it by your agent. Your agent takes it to the mortgagee and gives him your check and the mortgagee takes your check to the bank and gets the $27,000. But your agent instead of canceling that mortgage and releasing your property keeps the mortgage, has it transferred to him and when the interest becomes due on it demands payment from you.

Then eventually when the whole mortgage becomes due you have actually already paid it off in advance. Why demand that you pay it

again? It occurs to me that this is an illustration of exactly what is happening now with our Government bonds. That we have our agent take Uncle Sam's money, this other form of Government obligation I have just talked about and deliver it in payment for these bonds. Then instead of canceling the bonds like the agent failed to cancel your mortgage, why, this agent of ours, the Federal Reserve keeps it and demands that the taxpayers pay in enough taxes every year to pay that interest on that bond that has already been paid for. To make it worse and to indicate really that the Federal Reserve is flooding the country with printing press money and putting it in the wrong place, they reserve the right under the present policy of the Federal Reserve to sell that bond again after they have acquired it one time, they sell it again.

Now remember that credit is still outstanding and will remain outstanding from from here on out. Then when they sell it again they create enough money to buy that same bond again. They have doubled up on the inflation. Later on the Open Market Committee can buy it back, the same way, and issue more credit and money on the Government and then keep it a while and when the time is ripe sell it back again and create money again.

So will we ever get out of debt, Mr. Reierson, as long as Uncle Sam is compelled to pay his debts not only once but twice and three times? Will you explain to me the difference in that and the illustration I gave where the agent pays the $27,000 mortgage on your home and does not cancel the mortgage?

Mr. REIERSON. I hope you will bear with me if this is not a brief answer, because you have covered a variety of subjects, Mr. Patman.

Representative PATMAN. Well, we will reduce it to one, that where a principal gives his agent money to go pay a debt and the debt is paid, should the debt be canceled?

Mr. REIERSON. I think to begin with, that it should be made clear that when the Federal Reserve sells out of its holdings in the Open Market Account, funds are not created. To the contrary, this extinguishes credit. The payments are made by reduction in Federal Reserve bank deposit liabilities. Or in case Federal Reserve notes are turned in for payment it should not be assumed, as I think you have assumed, that you pyramid one transaction on top of the other, because sales out of the Open Market Account reverses the purchase and leaves us where we started.

Now as to the effect of this purchase: The liability of the U.S. Government under a Federal Reserve note is a contingent liability. The primary obligation, as a practical matter, is that of the Federal Reserve.

Representative PATMAN. Show me that on the document itself. The document itself should tell who is responsible for it.

Mr. REIERSON. I do not believe the Treasury of the United States has ever been forced to make payment on Federal Reserve notes. As a practical matter the Federal Reserve is responsible.

Representative PATMAN. There is no responsibility there. The U.S. Government promises to pay that on demand.

Mr. REIERSON. Payment in practice is made by Federal Reserve——

Representative PATMAN. You are talking about practice but I am talking about the document itself. The document carries the contract.

Mr. REIERSON. What happens in most cases is that the payments for the purchases by the Open Market Account are not made in Federal Reserve notes. Payments are made in deposit credit.

Representative PATMAN. But notes can be obtained?

Mr. REIERSON. Notes can be obtained yes, but the purchases in the great majority of instances are paid for by increases in deposit credit. Deposits also carry a 25 percent gold certificate reserve requirement.

Representative PATMAN. Let us get our definitions straight, if we may. You are talking about deposits in Federal Reserve banks as distinguished from deposits in commercial banks?

Mr. REIERSON. I am speaking of deposits in the Federal Reserve banks.

Representative PATMAN. I thought you meant commercial banks?

Mr. REIERSON. No, sir.

Representative PATMAN. But the commercial banks carry no gold reserve?

Mr. REIERSON. That is correct. So when the Federal Reserve system purchases securities on the open market, these purchases are made in the great majority of cases, not from the Treasury but from other holders and payment has to be made to these other holders and is made ordinarily in the form of deposit credit. Therefore, if one then approaches the problem of canceling these obligations held by the Federal Reserve, one gets into some very interesting practical problems. On the one hand I need not point out that the excess earnings of the Federal Reserve banks accrue to the Treasury. By virtue of the automation to which you have referred, the cost of clipping the coupons on the securities held by the Federal Reserve banks is not a very major drain, I do not think, on the Federal Reserve System.

Therefore, the Treasury is already getting the benefit, in the form of transfer of earnings from the Federal Reserve banks to the Treasury, of securities held by the Federal Reserve banks. Consequently, canceling $15 billion of these holdings would not mean any real saving to the Treasury. Beyond this, one encounters the intriguing and troublesome question, looking at the statement of the Federal Reserve banks, as to what you would do to offset this extinguishment of $15 billion of holdings of Government obligations. There are only two items on the liability side that are of any great consequence sizewise, Federal Reserve notes and deposit liabilities.

Now, if the Treasury of the United States were to cancel the Federal Reserve holdings of obligations I think we would both agree it would be unfair to cancel the Federal Reserve notes and simply tell the holder that his Federal Reserve notes are extinguished. If, therefore, one assumes that the Federal Reserve in all common honesty and decency could not do that, would it then cancel deposits? The total deposit liability of the Federal Reserve banks on January 27 was $18,800 million.

I point out that of this total the amount in member banks reserves was $17,600 million. If we canceled $15 billion of those we would either have to reduce reserve requirements of member banks to a very nominal figure or we would bring out a credit contraction and a crisis the likes of which this country has not experienced for a long time, which neither of us would want.

Representative PATMAN. You are overlooking two or three things I believe, Mr. Reierson. No. 1, you are viewing this from the standpoint of the Open Market Committee selling the bonds again rather than the original transaction. My question is, based upon the original transaction, that when an agent of the Treasury like the Federal Reserve, and the Federal Reserve is an agency of the Government wholly owned by the Government of the United States, takes Federal credit for Uncle Sam's money and pays another form of Government obligation which is interest bearing, that obligation should be canceled, as I see it, because the obligation has been fully paid.

As to the comments you made about the reserves involved in canceling Federal Reserve notes, there are several ways this can be done. There is one way set forth in a bill which I introduced and I would like to read you the language:

Be it enacted by the Senate and House of Representatives of the United States, That the Board of Governors of the Federal Reserve System shall direct each Federal Reserve bank to transfer to the Secretary of the Treasury an amount of interest-bearing obligations of the United States held by it such that the aggregate book value, the value of which such securities are carried on the books in the Federal Reserve banks' assets of the obligations so transferred shall equal to $15,000,000,000. Such transfers shall be effected not later than fifteen days after the date of enactment of this Act.

SEC. 2, the Secretary of the Treasury shall cancel and retire the obligations transferred to him pursuant to the first section of this Act and shall issue to each Federal Reserve bank a non-transferable non-interest-bearing demand note of the United States payable to such bank in an amount equal to the book value of the obligations of the United States transferred from such bank.

I think that effectively answers the point that you raised. You would probably state that that is still an obligation. But it is a non-interest-bearing obligation and non-interest-bearing obligations are not carried as part of the national debt of the United States. That is the reason that Federal Reserve notes, although the banks have issued about $31 billion of them, are not carried as a part of the national debt. They are not interest bearing. These would be noninterest bearing, but would cancel the obligation, that $15 billion. It would not hurt anybody that way.

The Federal Reserve would not be hurt. The commercial banks would not be hurt. The holder of Federal Reserve notes would not be hurt. Nobody would be hurt and the taxpayers would be helped because it would reduce the national debt by $15 billion, and we would have an opportunity then to balance the budget and make payments on the national debt. Do you not think that that proposal is in the direction of a sound one and feasible one and in the public interest?

Mr. REIERSON. No, sir, Mr. Patman, I do not.

Representative PATMAN. Why not?

Mr. REIERSON. If I interpret your proposed bill accurately, it would substitute a non-interest-bearing obligation of the Treasury for an interest-bearing obligation to the extent of $15 billion Treasury obligations now held by the Federal Reserve banks. It seems to me that you achieve little or nothing in reducing the net carrying cost on the debt, because of the present practice of turning over to the Treasury the earnings of the Federal Reserve banks. So for that reason I do not see that you really change the budget situation significantly one way or the other. Your suggestion, if adopted, would establish a very dangerous precedent, namely, that the Treasury of

the United States could force holders of its interest-bearing obligations to turn them in for obligations which carry no interest.

Representative PATMAN. Let me try another approach.

Mr. REIERSON. The non-interest-bearing obligations might not be included under the debt limit. Your suggestion, if adopted, would establish a very dangerous precedent, namely, that the Treasury of the United States could force holders of its interest-bearing obligations to turn them in for obligations which carry no interest. But I think that is an entirely different subject.

Representative PATMAN. As it is now, these $15 billion in bonds that have been paid for once with Government money are held by the Federal Reserve banks and the taxpayers every year must pay enough taxes to pay the interest on those bonds. Then they turn it in and the Treasury pays interest on it. To whom? To the Federal Reserve banks.

The Federal Reserve banks then turn the money over to the Treasury. Why do that when it is unnecessary? Why not reduce the national debt that much and save the taxpayers that much and then if they are going to pay that much more money anyway let them pay it on the remaining debt?

That money is not needed in the Federal Reserve. They don't need that kind of money. And even if this bill were enacted they would still have $12 billion to play around with. I am in favor of having enough money to pay their operating expenses and things like that although much of their service is rendered for the commercial banks. I am not saying it is not in the public interest although it is for the benefit of and saves the commercial banks that much money.

I am not arguing with you about that. But $12 billion would certainly be enough left to do anything that the Federal Reserve banks want to do and certainly enough to pay all expenses that the banks would need. They normally have about $140 to $150 million expenses which they deduct and then turn the balance over, 90 percent over to the Treasury and then later on the other 10 percent. At the end of the year Mr. Martin stated that he turned over $266 million out of the surplus fund.

Do you not think that when the Federal Reserve has money like this surplus fund of nearly a billion dollars up until the end of the year which they do not need, which is idle, and not invested, and doing no one any good, do you not think that ought to be turned over to the Treasury to reduce the debt and save the people that much interest, Mr. Reierson?

Mr. REIERSON. I am a little at a loss to know which billion dollars you are speaking of.

Representative PATMAN. Surplus funds, it was about a billion at the end of 1959. Mr. Martin gave out a statement in which he stated that the Federal Reserve was going to accommodate the Treasury by paying $266 million of the surplus funds into the Treasury.

So the point is why pay $266 million, why not pay the whole billion dollars into the Treasury. The Federal Reserve does not need or use the remainder. It is idle. It is not invested. It does not help the Federal Reserve. It would help the Treasury and would help the taxpayers.

Do you not think the balance of that surplus should be turned over?

Mr. REIERSON. I think this is a question you should ask the Chairman of the Federal Reserve.

Representative PATMAN. I will be glad to do that.

Next about stocks, some of the banks are acting as though they own the Federal Reserve. You see in the paper now and then a statement from a bank as though they actually own the Federal Reserve. They have about $400 million in what they call stock. And of course the evaluation of that stock means it is not stock at all. The word "stock" is a misnomer and should have never been used. But the effect of it is that these banks pay in 3 percent of their capital in surplus into their Federal Reserve bank in that region and what do they do with that $400 million? The Government is paying Federal Reserve about $21 million to $25 million interest on that so-called stock and the money that the Federal Reserve has in this so-called stock is not needed. It is not used.

I have challenged the members of the Board time and again to name me one use that that stock is put to. It is not invested. It is idle. We are paying 6 percent for it and not using it at all. Do you not think that so-called stock should be turned back and the Government saved $25 million a year.

Mr. REIERSON. I certainly would not presume to speak for the Federal Reserve as to the necessity of maintaining an adequate capital account.

Representative PATMAN. What would you have a capital account for? You use the credit of the Nation in the Federal Reserve. A central bank does not use capital.

Mr. REIERSON. There may be occasions when even a central bank may encounter losses on some of its assets. Besides which, these capital funds are not idle. They are invested.

Representative PATMAN. Show me where they are invested.

Mr. REIERSON. The funds represented by the capital stock are included in the assets.

Representative PATMAN. But what are they invested in? They do not invest them in Government bonds because they create money to buy Government bonds. They say that.

Mr. REIERSON. Obviously we cannot look at the liability side of the balance sheet and then track down or assign a particular liability item to a particular asset. We do not have red, white, and blue dollars. The funds that were paid originally for the stock of the Federal Reserve bank were invested by the Federal Reserve banks in some form of asset.

For the most part this was done many years ago and it is utterly impossible to determine at this time where the funds that were paid in are now invested. But they are included in the assets of the Federal Reserve bank.

Representative PATMAN. I want to make this comment and then I will yield to another member of the committee.

For your information, Mr. Reierson, when the Federal Reserve banks were created, at that time regional banks, not a central bank like now, there was about a billion and a half dollars in reserves that the different banks joining the systems were keeping in their own

banks as backing for their credit, and they transferred this billion and a half dollars over to the reserve accounts, to their reserve accounts in the regional Federal Reserve banks, just a billion and a half dollars.

Now since that time they have not only drawn out that billion and a half dollars, but they have gotten $47 billion besides that. And $18 billion of it is what you referred to a while ago as a Federal Reserve account of these banks. The banks did not actually put money in there for that. That was given to them. They call it making it available to them. They did not put up a dime of that money. So they did not invest their money at all. They did not have any money to invest.

I yield, Mr. Chairman.

The CHAIRMAN. Congressman Kilburn.

Representative KILBURN. I just have a question or two in relation to what Mr. Patman said.

Mr. Reierson I should think, if I understand this correctly, since the Federal Reserve is owned by the Government instead of using these non-interest-bearing notes that would be substituted and thereby reduce the debt, I should think it would be a lot simpler if you simply printed $255 billion worth of money and paid it off, gave them the money. This would be non-interest-bearing too, and it would clear the whole thing up. What do you say to that?

Mr. REIERSON. I would not be in favor of that. Obviously this would bring on consequences that would be very serious, if we were to monetize the entire Federal debt. It would be a form of repudiation on the part of the Treasury.

Representative PATMAN. I hope the gentleman is not quoting me.

Representative KILBURN. I am not quoting you. I said it would be a simple method. I am not advocating it or your system either.

I would like to just ask another question, Mr. Reierson: Regardless of the economic arguments in these situations, to the ordinary citizen of this country, the big thing that keeps our money good is the confidence of the people in the country in that money, is that right?

Mr. REIERSON. I would agree.

Representative KILBURN. Whether you have 75 percent of gold behind it or 10 percent or 1 percent, if the people of this country ever lose confidence in our money we are sunk, is that right?

Mr. REIERSON. Yes, sir.

Representative KILBURN. And anything we do in the Congress to make them lose confidence in it, I think, is wrong. Do you?

Mr. REIERSON. I am in complete agreement.

Representatives KILBURN. There is one question I would like to ask Mr. Henle.

In thinking about your figures on unemployment percentages, it has been my observation that there are a lot of people in this country who will not work.

They do not want to work. Do you take that segment, whatever it is into account in your unemployment figures?

Mr. HENLE. Well, let me make clear at the start that the unemployment figures that I was talking about are not my personal figures.

Representative KILBURN. I understand that.

Mr. HENLE. They are the Government's figures. The Labor Department has worked out elaborate procedures in connection with their monthly survey, covering a sample of all households in America. This monthy survey is taken at a particular time each month during a particular week, I think the week in which the 12th of the month occurs.

The object of the survey is to classify people according to their activity the previous week. They ask this question of the respondent, who is normally the housewife, but they ask it for each person in the household who is 14 years of age and over.

They have a prescribed method for asking these questions. This prescribed procedure and the questions that are asked do tend to probe so that, for example, a person who ends up classified as unemployed is a person who has to show by and large that he was actually seeking work. He did not just want work. He did not just say he wanted to work last week and could not find it. There has to be some indication that he was looking for work, registering for unemployment insurance, registering at the Employment Service, out checking with employers, inquiring at factory gates, things of that sort. As a matter of fact, there is and perhaps always will be a problem in classifying people as employed, unemployed, or not in the labor force. Some people feel that the Department of Labor is too strict in terms of its criteria and that for example they may not include as unemployed everyone who actually was looking for work.

Representative KILBURN. My point is this: If there are for example 2 percent of the people who do not want to work and we show unemployment at 3 percent, we only have 1 percent unemployment.

Mr. HENLE. I think that is playing fast and loose with figures because after all only 42 percent of the people 14 years of age and over declare themselves as not looking for work and not employed. In other words, they are not in the labor force at all.

Thus, your 2 percent who do not want to work is really 42 percent who do not want to work, the students, housewives, older people, and so forth. In the group of men, age 25 to 55, there will be something like 95, 97 percent, who will be interested in working. Even there it is not a hundred percent.

Representative KILBURN. That is my point. If you had say 2 or 3 percent of the people from 25 to 55 say, who just do not want to work. I was just wondering if those people were included in the unemployment figure?

Mr. HENLE. No, they would not be included.

Representative KILBURN. Thank you.

The CHAIRMAN. Mr. Reierson, I wonder if I might ask you some questions on this ratio of liquid assets to the gross national product which you included in your paper which you cover I think on pages 15 to 19 of your memorandum.

Now I suppose I am somewhat old fashioned. I had always assumed that the money supply consisted of currency plus demand deposits. If it is taken as the test, this has increased at a slower rate than the increase in gross national product during the last 6 years. Now to that you add "Money supply," roman 2, which I take it consists of currency demand deposits plus time deposits?

Mr. REIERSON. That is correct, time deposits in the commercial banks.

The CHAIRMAN. Then you get "Liquid assets, I," which adds to that deposits in building and loan associations, mutual savings banks?

Mr. REIERSON. That is correct.

"Liquid assets, II" adds to this 1 year and shorter Treasury obligations held outside the banks.

The CHAIRMAN. Now, in this do you assume that the liquid assets other than currency and demand deposits have a 1 to 1 relationship? That is, that a dollar of time deposit and a dollar of deposit in the building and loan associations is as much money, that is, passes from hand to hand, as a dollar of currency or of demand deposit?

Mr. REIERSON. I think this is a very valid point. I would not assume the same degree of turnover.

The CHAIRMAN. When you figure out your percentages you are taking a dollar as a dollar regardless of whether it is "Money supply, I," which is the conventional "Money supply II;" is that true?

Mr. REIERSON. That is correct. I have not attempted to adjust or refine this.

The CHAIRMAN. Our committee commission had Professor Gurley make a study on this amongst other subjects and in his study paper, which is our No. 14, on page 50 he attempts to correct for this and gives to a dollar of liquid assets, other than currency and demand deposits, the equivalent of 50 cents of the time deposits plus deposits in building and loan associations and mutual savings banks and short-time Governments held by individuals outside the bank. This requires $2 to equal a dollar of what is conventionally termed money. And when he does this, I will pass this down to you, he shows the ratio of this corrected figure for active liquid assets to have been approximately constant from 1946 to 1957 at between 0.65 and 0.75, with however a jump up in 1958. In other words, he corrects for the slower turnover of these other and less liquid forms of what some people call money, but which I do not regard as such.

Have you seen this study? Is this perhaps not a truer statement that yours?

Mr. REIERSON. Mr. Chairman, I have not had an opportunity to read the Gurley document. I certainly agree in principle with your observations that these liquid assets are not completely identical with demand deposits. I would, without studying the Gurley document, not venture a guess as to whether I would agree with 50 percent adjustment. I think what we should do, Senator, is to look at this in terms of what has been happening in recent years and consider the large increases in holdings of liquid assets in recent years. I think two things have happened. I am sure that individuals have transferred money into savings media to an increasing extent in recent years in order to obtain an interest return and that they are using these media more generally as the equivalent of checking accounts than was the case 10 years ago.

Second, in the case of corporations there is no doubt that within the past few years corporate treasurers have become much more alert to the income advantages of holding time deposits and Treasury bills and have shifted a large part—have shifted substantial amounts of demand deposits into time deposits and Treasury bills which, while not the exact equivalent of demand deposits, are very close. So I think instead of taking a blanket percentage to be applied over an

extended period of time, we might investigate, if we can, asset-holding habits in terms of changes in these habits that have developed say within the past 5 years. This is the period during which most of these changes have developed.

The CHAIRMAN. At the very least the real increase in liquid assets which have been used as a form of money have not been as great as indicated in your chart this morning?

Mr. REIERSON. That I would agree with. This is one of the refinements of which I was cognizant but which I could not undertake within the time available.

The CHAIRMAN. Now on the question of the leads and lags between the discount rate of the Federal Reserve banks and the short time—short-term money rates. As I remember your statement you said that for a period of time the movements of the discount rate as announced by the Federal Reserve banks preceded the increases in the short-term money rate; is that correct?

Mr. REIERSON. Could I project the relevant chart?

The CHAIRMAN. Yes.

Mr. REIERSON. Seventeen, please.

(Chart projected on screen.)

I made the point, Senator, that in 1958 and 1959 the discount rate, except for a period of perhaps 3 months, did not lead the market rates. The only period in which the discount rate advanced faster than, or was above the market rate was a period of 2 or 3 months in 1959. During the rest of the period, the market yields went up before the discount rate was adjusted. In the latter months of 1959, market yields went up very materially, but the discount rate was not raised.

The CHAIRMAN. Did you study years prior to 1958?

Mr. REIERSON. I have charts which cover earlier periods. I think the pattern of movement in 1958 and 1959 is likewise true of a longer period; I shall be delighted to submit charts covering longer periods of time if it would be of interest to you.

The CHAIRMAN. So your conclusion is that it is the short-term rate which tends to lead the discount rate?

Mr. REIERSON. Yes, sir.

The CHAIRMAN. Not vice versa?

Mr. REIERSON. That is correct.

The CHAIRMAN. Congressman Curtis.

Representative CURTIS. I would like to ask a couple of questions of Dr. Brandow, on the agriculture section.

I am glad to see Dr. Brandow back before the committee. He did an excellent job has head of our staff looking into the problems of agriculture economics.

In discussing this matter, Dr. Brandow, I want to find out what the definition of a farmer is as you use it in your paper.

Mr. BRANDOW. I have used the same definition as the Census does and which the USDA uses. I am not sure I can repeat precisely what that is but essentially a piece of land on which $150 worth of farm products are produced, and that is 3 acres in size, is a farm. I am not sure that the is precise definition but $150 in value of farm products produced in general makes the place a farm.

Representative CURTIS. Are they not working over that definition?

Mr. BRANDOW. It has been revised for the purpose of the 1959 census so as to exclude the rather substantial number, it might be on the order of half a million, who are down in that $150 area.

Representative CURTIS. I have always thought and I think our studies try to make a distinction between commercial farming and that which is not commercial farming, people who live in rural areas and do a little farming and I think it is very important from an economics standpoint to distinguish because they present two different problems. It struck me that commercial farming, and again I would have to get some help from you in defining what is commercial farming, but it would certainly not include many of the farmers that are included in the definition of farming. Could you supply a definition for me of commercial farming?

Mr. BRANDOW. Well, this line is very hard to draw and any time we draw it we are being rather arbitrary. Two years ago the committee drew it at a value of sales of $2,500. The farmers who sold at least this much in the 1954 census comprised 44 percent of all farmers and sold about 90 percent of all the products put on the market.

Representative CURTIS. Those are the figures I meant. That is what I was seeking. Now, is that sector of the rural communities, the commercial farm sector doing well or indifferently and what are the prospects for them?

Mr. BRANDOW. My statement here applies mainly to the commercial farm sector and its outlook for 1960 vis-a-vis 1959.

Representative CURTIS. Yes.

Mr. BRANDOW. Now, in general their incomes are at a substantially higher level than especially the farmers who sell less than $2,500 worth of products and still have very little nonfarm income. Such farms make up about one-fourth of the total. The commercial farmers have higher average incomes than they by quite a bit. But the prospects are that net income for commercial farmers will be somewhat lower in 1960 than in 1959.

Representative CURTIS. Net income will be lower?

Mr. BRANDOW. Yes. Not by much.

Representative CURTIS. Do we eliminate the hobby farmer, the wealthy man who buys a farm and, I regret to say, uses his losses there frequently against his tax?

Mr. BRANDOW. There are some of those folks who sell substantially more than $2,500 worth of product. This is the only criterion used above $2,500 so to the extent that there are folks who have substantial outside income but who sell more than $2,500, they are included in what I would call commercial agriculture.

Representative CURTIS. I think it very important that we start developing our farm statistics on the basis of commercial farming and then direct our attention to this other problem which is a real problef of the person who lives in the rural community who still is defined as a farmer but actually has found out he can no longer make a livelihood from farming.

In your paper you pay a little attention to that when you are pointing out the increase in income obtained from nonfarm sources by some kind of man on the farm. Essentially that is in this noncommercial farm sector is it not? Or is it?

Mr. BRANDOW. A great deal of it is there, yes, but the 1954 census showed that even if you go up to the so-called class 1 farms which sell more than $25,000 worth of products annually, there are, on the average, appreciable amounts of nonfarm income. Really no class of farming taken in the aggregate contains an insignificant amount of nonfarm income.

Representative CURTIS. I did not realize that. I had assumed the bulk percentagewise to their income——

Mr. BRANDOW. This would be very true of the noncommercial farmers. The relative importance and, probably, the absolute amount of nonfarm income is greater for noncommercial farmers than for the commercial farmers. But especially among the smaller commercial farmers it is a significant thing.

Representative CURTIS. I think it is most important to keep this distinction in mind because if we continue to try to solve nonexisting problems of the commercial farmers through attempts to solve the problem of the noncommercial farmer we are not going to end up very well as far as handling agriculture problems. Likewise, I do not think we will do a very adequate job of solving the problem of the rural people who can no longer depend on agriculture as their main source of livelihood.

Mr. BRANDOW. I agree. This distinction is very important. The solutions, in terms of policy, lie in opposite directions.

Representative CURTIS. They do. I may be unduly critical of the figures but I do not think economic statistics tend to draw that line. One other area, on farm labor, Has farm labor been increasing in size?

Mr. BRANDOW. The farm labor force has been declining. This is true of both the hired and the family labor.

Representative CURTIS. I want to distinguish between the family and the hired. Even the hired has declined?

Mr. BRANDOW. Yes. Although in the past 2 or 3 years the declining trend has not been strong.

Representative CURTIS. Possibly some of that to a large degree is the result of mechanization?

Mr. BRANDOW. Mechanization is the prime reason for the decline in both family and hired labor.

Representative CURTIS. Which creates jobs in farm machinery, in selling it?

Mr. BRANDOW. To some extent, although the manufacture of machinery and the petroleum industry are usually located some place far outside the farm community.

Representative CURTIS. Now, if I may ask Mr. Henle, there is one thesis that I have tentatively adopted, that as we have rapid technological growth almost axiomatically we are going to have increased frictional unemployment. Would you agree with that or not?

Mr. HENLE. Yes, I think that would be a sound conclusion and I think some of the developments I pointed to in my statement bear this out. The simple fact is that most of our unemployed are more or less in the semiskilled or unskilled groups whereas there is continuing a great demand for more skilled, white-collar groups, technicians, and professional people.

Representative CURTIS. The reason I wanted to point that up is that some of the people who seem to be arguing the most for increased economic growth and I think that is certainly a desirable objective, are I think shutting their eyes to the fact that if we increase the growth more rapidly we are going to aggravate the friction of unemployment and probably increase our incidence of unemployment. At least, let us put it this way, we certainly aggravate the problem and unless we are set up to do a better job than we have been doing in this problem of the frictional unemployment we are going to increase the amount of unemployment.

Mr. HENLE. My personal point of view would be that we can do a better job to improve growth and we can at the same time do a better job in providing job opportunities for those people who might be displaced.

Representative CURTIS. Yes, but I do not think we want to think that growth is at no cost. I think growth is at the cost of increasing the problems of frictional employment. Now, I would like to look at the high incidence of unemployment that you point to. I would like to look at it from an economic basis first before we start choosing up political sides on these things, I want to see what economic reasons there are for this, not casting political blame although there may be political blame to be cast at sometimes, but certainly to find out the economic reasons. I suggest in the agricultural area where we have had such rapid technological advancement that it is referred to as a revolution there is the area where we have the greatest incidence of frictional unemployment. If that is so let us recognize that growth is probably going to have in its wake this incidence of technological unemployment.

Mr. HENLE. I am not familiar enough with the analysis of this problem to be able to substantiate your point that it is in the agricultural area where there is a greater amount of frictional unemployment.

Representative CURTIS. We know this, let us go back to Dr. Brandow who in his testimony shows that here we have got people out in the rural areas that we call other than commercial farmers whose skills are no longer being utilized and who find themselves not being able to make a go of it or at least their having a hard time to make a go of it. It is one of the big sources today of our unemployment, new employment in the airplane factories and elsewhere around the country, they come from the rural areas. Of course, there is some tradition for that.

Mr. HENLE. Well, during World War II, of course, there were a large number of new plants that were located in these rural areas and there has been additional location since then. I suspect, however, that much of this agricultural unemployment problem is really more technically classified as underemployment.

Representative CURTIS. That might not be included in the unemployment statistics?

Mr. HENLE. That is right.

Representative CURTIS. I expect a lot of it is true but I expect that now that many of these people in this area do use nonagricultural sources for revenue, for income, and I think our studies of unemployment compensation demonstrate that many of those people are now

under unemployment compensation. Some of them in the State of Michigan, I think, have adjusted themselves to that procedure.

Mr. HENLE. I am not familiar with those particular studies. I was thinking of people in some of the sections of the South who would consider themselves as farmers trying to make a living out of their farm even though they were not fully employed——

Representative CURTIS. And who would not answer the question that "I am one looking for employment"?

Mr. HENLE. Yes.

Representative CURTIS. Now to get to another area as to which I cannot understand why our educators do not talk about and why our people who are concerned with employment do not talk about. That is the impact of the draft law on employment. I saw some figures, some figures have been presented to this committee which show a great incidence of unemployment in the younger age groups, the very age groups that are subject to draft. An employer frequently is reluctant to employ someone whose draft status is uncertain and I suspect that that probably is of considerable impact on that group of people. Then we see that the figures bear out that incidence of unemployment among these younger groups is unusually high. So I relate that, of course.

Mr. HENLE. Frankly, Congressman, I do not think that that would have a major impact. It may be reflected to some extent in the figures but after all we are drafting a very small number of people these months.

Representative CURTIS. If I may interrupt, it is not so much who is actually drafted as much as the uncertainty that is created in these young men's future. The incidence of unemployment, I forget that chart but one of our witnesses presented it and it shows 16 and 17 percent.

Mr. HENLE. For certain age groups it may be as high as that.

Representative CURTIS. It is mainly male. It was not for female.

Mr. HENLE. May I point this out?

Representative CURTIS. Yes.

Mr. HENLE. Even if there was this uncertainty that you speak of, I find it difficult to believe that a large number of these young people would be hired in the absence of sufficient demand in the economy for the products that they would be turning out. In other words, if an employer has the need for an additional person, he may be reluctant to hire a particular young man but he would be hiring somebody.

Representative CURTIS. He would be hiring somebody, yes.

Mr. HENLE. And I do not think therefore that you can blame the draft law with the responsibility for high rate of unemployment in the young age group. This will continue to be a problem, and it may be a more acute problem as the postwar baby boom starts to move into the hiring age.

Representative CURTIS. The other point, as Senator Douglas has often emphasized, in this business we ought to know a little more about the underemployed. Then we have overemployment. I regret that there has not been a real study made of overemployment. We have got these demands for many skills; you can look in almost any Sunday New York Times, page after page of advertisements for skilled people. Then there has been this marked shift, we see it even in broad statistics from the blue-collar to the white-collar work. Do

you not think it would be valuable to have a study made of overemployment too, to find out where these areas are that we need skills? That is, theoretically, what we should be doing much more of in our unemployment insurance programs.

Mr. HENLE. The Labor Department, the Bureau of Labor Statistics, who provide occupational information, regularly publish the "Occupational Outlook Handbook" to guide young people in choosing a career. It gives a summary of occupations, possible earnings, demand for skills, and so forth. The Labor Department does investigate this type of problem and they write up these reports to emphasize the particular occupations that will be most in demand. I personally would not use the word "overemployment."

Representative CURTIS. That is a poor phrase. I was seeking for a correct counterpart of "underemployment." I do not know what you would call it.

Mr. HENLE. These are skills that are much in demand. I personally happen to believe that many of the business firms and corporations of America have adopted somewhat the wrong attitude regarding these skills. They will go into the New York Times and other prominent periodicals to advertise away and bid away high talent from other firms.

Representative CURTIS. Yes; there is some of that.

Mr. HENLE. Rather than, in my judgment, trying to analyze their job requirements and seeing if there is not a possibility for them to break down the jobs and to hire people of lesser skills.

Representative CURTIS. I could turn around the answer I thought you gave me which I thought was a good answer with respect to the prospective draftee, if the job were there someone would be employed. So if in this instance if this job were not filled so it is a vacant job, it is a job and people are looking for someone to fill it.

Mr. HENLE. Yes; my point is that the job is there but that there is not enough imagination in the personnel business to see that this vacancy could be filled in some other way.

Representative CURTIS. Or imagination on the part of the employee, potential employee, the man who is out of work possibly to see. It works both ways.

Going on, though, just a little bit further in this area of—I wish I had a proper term, needed skills, overemployment, I appreciate is not such a good term—we get the situation where we actually go down to Mexico to get the labor to do the work on the farms. That is done with the permission, I understand, of the labor unions, and the law is written that that cannot be done unless no one in our country will take the job. I appreciate why our people do not want to do this stoop labor, but the very fact that those jobs do exist, though, indicates that this unemployment problem certainly is not what it was in the thirties to which it is often related. People are not quite that bad off, apparently.

Mr. HENLE. Let me say that I think that you have been misled about the attitude of the unions toward this issue.

Representative CURTIS. I would like to be corrected on that.

Mr. HENLE. The unions have definitely felt for many years that this program of importation of Mexican workers has worked to the detriment of American workers who were interested in full-time jobs in agriculture.

Representative CURTIS. The farmers could not get workers. I talked to many farmers who import the Mexican laborers, and they said they cannot get people to do the work. Maybe you would say, "Pay them three times what they do." On the other hand, their wage scales are fixed at what is the usual rate, the going rate in the community, in the State.

Mr. HENLE. You get into a vicious cycle, because the Mexicans are supposed to be paid the so-called prevailing wages. However, the fact that Mexicans have, for example, been employed last year and the year before means that there are not going to be many native Americans around looking for agricultural work in this area, simply because they know there is a Mexican program, and they know such a Mexican program is actively encouraged by the growers. The result is that when the Mexicans come in at the "prevailing" wage, the prevailing wage has been depressed simply as a result of the operations of the Mexican program for many years back.

Representative CURTIS. I am sure that most farmers would prefer to get labor within the area if they possibly could, because it is a costly thing to go down to Mexico.

Mr. HENLE. Well, the taxpayers, too, are paying a good bit to support this program. Farmers are charged something, but farmers receive benefits, let me assure you, in terms of the generally low level of wages that are paid that might not be paid if the program were abolished, the fact that the Mexicans constitute relatively docile labor and the absence of any labor disputes with the Mexicans.

Representative CURTIS. I honestly do not think that is the reason behind it. It developed, as nearly as I can tell, I know a little something about it, I have seen it grow, and I honestly believe it is because they could not get the labor and still cannot.

Mr. HENLE. That is a matter of interest and controversy in and out of the Government. There have been special areas that have been selected as part of the special drives to see if field crops could be harvested by American labor and in a number of cases they have been able to demonstrate that the jobs can be filled by Americans. Under the Mexican program, no Mexican is supposed to be brought in if there is an American able to do the job. But frankly, Congressman, we have had a number of complaints about this.

Representative CURTIS. I was bringing it in as it related to this whole study of what is unemployment in the year 1960.

The other factor which I think would need studying is the amount of moonlighting that goes on, I think that is the expression used for people holding two jobs and I have seen some varying studies on it, but I would think we would want to get figures in that area, too. Would you agree?

Mr. HENLE. Yes, I do. Let me say though to finish up on Mexicans——

Representative CURTIS. I did not mean to interrupt.

Mr. HENLE. I do agree with you that in the light of today's unemployment levels there is every reason to take a closer scrutiny at the operations of a program that may in fact be importing workers from other countries to do work that perhaps Americans can and should be doing.

On "moonlighting" or as it is more technically called "dual jobholders," the Labor Department does do special work in this field. They

have just finished a survey covering the month of December 1959 in this area.

Representative CURTIS. Would they show up in the statistics as two different people holding jobs when we say total number of employed, would that show up? It would, would it not?

Mr. HENLE. No, it would not. Let me explain it this way: The monthly figures, the figures looked at most closely, are total employment. These are obtained by household interview so each person is counted only once. The Bureau of Labor Statistics also collects employment information from employer payrolls where they report number of people on payrolls. In that case a person might be counted more than once if he is on more than one payroll.

Representative CURTIS. They compile statistics from both staffs; is that right?

Mr. HENLE. The statistics from both types of surveys are available. The basic data covering the economy as a whole is the household survey where each person can only be counted once and from that we get our figures of unemployment. The payroll figures are by industry and do not cover the entire universe, do not cover the self-employed, domestic servants, or agriculture.

Representative CURTIS. I thank you. I just think that, it just seems to me that if we want to continue to have rapid technological advancement and I think we probably do, we ought to relate it to this problem of unemployment and recognize that we are probably going to increase the incidence of this frictional unemployment unless at the same time we do a lot more than we are doing in the area of education and training and retraining.

Mr. HENLE. What I think has happened is this: The studies of adjustment to technological change, to the introduction of automatic equipment, for example, that have been done by the Labor Department, show in the main that a lot of people have not become unemployed as a result of the introduction of new equipment; both because there has been union protection and because there has been employer interest in preventing large-scale layoffs.

Representative CURTIS. I could give you specific example after specific example. Just recently Shopleigh Hardware in St. Louis shut down, simply because of technological advancement in the distributive field, which we do not tend to think of—and I guess it is in the development of transportation—eliminated the need for wholesale hardware. And now we have I do not know how many hundreds of people who no longer have jobs. And there is just instance after instance that comes to my attention, where technological change has brought about that kind of loss of jobs. A lot of these people can shift over and get relocated. But as we do advance, I do not know what the supermarkets have done in the way of eliminating employment for the thousands and thousands of small corner grocery people, but I am convinced that if we ever made a thorough study of it we will find—I say it is axiomatic simply because I have not seen any studies, that rapid technological change would bring in its wake this thing. And all I am pleading for is that those who think we should have more growth will recognize that we probably are going to have more of this type of unemployment.

Mr. HENLE. I did not mean to imply that there were not people displaced. Actually, the studies I was referring to would relate to

those people whose jobs were affected directly within a firm by the introduction of automatic equipment. That is a little different.

Representative CURTIS. That is because I think we have got a very good system of Federal-State unemployment insurance that encourages the employer to keep down his incidence of unemployment.

We had an argument with some of your leaders of the AFL-CIO on that. I think it is that very incentive system that keeps the incidence of frictional unemployment within a single concern at a minimum level.

Mr. HENLE. You do not want to give the employers themselves any credit for keeping people on the payroll?

Representative CURTIS. Sure, I do. I want to give them a lot of credit, because if their testimony is correct, like the testimony of the president of Pacific Bell, when they shifted to the dial system, they deliberately did it over a period of 2 years, so that they would not displace all these girls and would give them a chance to retrain for other work. His testimony is that there certainly was a significant factor, that they knew that their rate of tax, unemployment tax, would be lower if they had a minimum amount of unemployment.

So I think there is a real economic incentive involved there. Whether that is the controlling thing, I do not know.

Mr. HENLE. Of course, even in a situation of that sort, if the individuals themselves are kept on the job or on the payroll, in effect such a firm is out of the job market for the next 2, 6, or 12 months, until nominal turnover takes care of their employment problem. Then, of course, as you related, there are many instances where the incidence of automation in a particular industry affects a firm that is perhaps entirely outside the industry, making its operations obsolete. So in the last analysis, when you add all these things up, it does amount to an impact.

But what I was saying was this: You suggest that if we are going to continue to have technological change, this may mean a higher level of unemployment. I would modify that by saying if we have rapid technological change without an adequate growth rate of 4 to 5 percent, yes, that is true. But if at the same time we can step up our growth rate somewhat from the record of the last few years to a level of 4 to 5 percent, then that in itself will generate the need for more jobs.

Representative CURTIS. That is where the growth comes. And you get the jobs over here, but you have the people untrained; which comes back to what I was saying. You have a great area of overemployment.

I wish I had a better term to get across what I am thinking.

Mr. HENLE. In any case, I agree with you, that we need to have better types of training and retraining facilities, so that a person who has no skill at all, or a skill that is not in demand, can be retrained to a position where he has assets that will enable him to get a job.

But in any case, even if we have retraining facilities but still do not have the greater growth in the economy as a whole, we are not going to provide the necessary jobs. So I think you need both.

Representative CURTIS. I could not agree more that we want the growth. All I am pleading for is that people not think that it is at no cost. There is real cost involved in growth. I personally am will-

ing to pay it, and I think we can figure out a way to do it without it costing too much. But I do worry about people who just say that the way to solve unemployment is to have 3 or 4 percent growth in gross national product per year; when actually, within the economy itself, there is created this high incidence of unemployment.

Mr. HENLE. There may be other ways to get your 3½ or 4 percent or more growth besides accelerated technological change.

Representative CURTIS. I surely do not want to see any more growth than we have had in the agricultural sector of our economy. There are sectors in which we can overdo it. There are other areas in which we need more, perhaps.

Mr. PARADISO. Congressman, may I make a comment on this?

Representative CURTIS. Yes; I would be very happy to have you do so.

Mr. PARADISO. Has not the history over the past 50 or more years sort of borne out the fact that over the long run with the 2 percent growth per man-hour, which essentially has reflected our increased efficiency, we have been able to absorb the increase in the labor force? You are perfectly right, of course, that in any period these people are becoming unemployed as a result of this increased technology and may go through a very troublesome time, yet with new industries coming in, with new products, and other things of that nature, we have demonstrated that we have been able to get back each time to a full employment situation with an average rate of growth per year amounting to 3 percent? And that I would put forth as a combination of a 2 percent increase in production per man-hour, on the average—and I am talking now not just of this recent period, but going 'way back, say, to 1900—coupled with an increase of 1 percent on the average in man-hours.

But you are perfectly right. Over a short period there are going to be problems. But over the long run, I think Mr. Henle's point was pretty much this: The system has been such, with new enterprises, new industries coming in, to take into account the increased labor force.

Representative CURTIS. I think so. I agree to that. I just make the point, though, that if we are in a period where the rate of technological growth is greater than, say, another comparable period, this short-range frictional unemployment is going to be aggravated. And I do not know that this is so, but maybe that is the reason we are seeing this increased level of unemployment after each one of these recessions are over.

On the other hand, maybe our statistics are just getting better and we are measuring a little better what has always existed. I do not know.

Mr. SMITH. Mr. Curtis, I wonder if I can make one point. In my statement on a table which shows increases in consumer spending over the past few years, if you will notice in the middle of the page there, spending on services has gone up 101 percent in 10 years, as contrasted with a 75-percent increase for durable goods, and only a 53-percent increase in nondurables.

The point I wanted to make here is that we are concentrating more and more on services in the economy, and services are extremely hard to automate. It is very difficult to automate a haircut.

Representative CURTIS. But you automated the grocery store.

Mr. SMITH. Yes. I happen to be in a service industry myself, and we are struggling with this problem of automation, and it is very difficult to accomplish.

Representative CURTIS. They do it in ways that we do not think of. But, like the elimination of Shopleigh Hardware Co., which is in effect automation——

Mr. SMITH. I happen to be from St. Louis myself. I think there were some other geographical factors there, too, were there not?

Representative CURTIS. Well, your hardware, like Shopleigh, has gone out of existence. I think it is partly transportation; it is probably the distribution pattern from St. Louis. But we are putting more and more employment into the service area, where it is absorbing a lot of the technological unemployment from the manufacturing. Have we not got a lot of overemployment in the service industry, too? The plumbers, the TV repair people? Take your technicians in the hospital. There is a great demand for them, which would further indicate this very point I am trying to illustrate.

Mr. SMITH. There is some duplicate employment in the field, too; a lot of weekend work and night work in these types of operations.

Representative CURTIS. I always have suggested that the do-it-yourself movement in this country resulted from the family's response to the fact that there was overemployment in this area, and they pretty well had to do it themselves or not get it done.

Mr. SMITH. I think do-it-yourself is the price we have to pay for leisure time.

Representative CURTIS. Thank you, Mr. Chairman.

Representative PATMAN. The committee is indebted to you gentlemen for giving us the benefit of your information and great knowledge. We appreciate it, and it will be worth a lot to us.

I would like to interrogate each one, but I will not have the time to do that. I do not want to take up too much of the time of the committee.

I do want to comment on what my colleague, the gentleman from New York, Mr. Kilburn, said about confidence in money. I agree with him that you must have confidence in money. You must have confidence in your country. You should have a balanced budget. I think the biggest deterrent to progress we have is our huge national debt. We must, I think, pay it down substantially.

Now, on confidence, this question of money comes up. Next week we will be celebrating the birthday of a great American, a former President of the United States, Abraham Lincoln. During Lincoln's time, during the War Between the States, he issued $360 million worth of currency. They just called them greenbacks, printing-press money. The people did not have confidence in that money, and it went down in value. It did not go down to where it was not worth a continental, but it decreased greatly in value, as we all know, reading from the history books. But when the Congress placed about 30-percent gold behind these $346 million of greenbacks, as they were called, there was complete confidence, not because of the 30-percent gold, but because of the little phrase they wrote on each one of these greenbacks, and that was to the effect that "This money is good for the payment of all debts, public and private." That is what gave it confidence.

And, of course, that is what confidence is in money, the way I construe it.

You take this dollar silver certificate. That is good. You can take that to the Treasury and get silver that is worth about 9 cents for it. Well, people accept this as worth a dollar. And they should because on this silver certificate it reads: "This certificate is legal tender for all debts, public and private." So that is the reason that the peeople have confidence in it; because they can use it for the payment of debts and taxes. And you take this Federal Reserve note, that has behind it, of course, 25 percent gold, at least; but under our laws you cannot get gold. It has a gold certificate behind it equal to 25 percent.

That is, it is a fiction, because the gold certificates have not actually been printed. So it has a fictional gold certificate that cannot be used to acquire gold behind this certificate. They say that gives confidence.

My theory is that it is helpful, all right, but the real confidence is in the language on the Federal Reserve note, which says: "This note is legal tender for all debts, public and private."

So as long as we can use this paper money to pay debts, and we all owe debts, and we all owe taxes, of course, there is always confidence in money; not because of some fictional gold certificate that has not legally been printed, but because they can use it at the grocery store or to pay taxes or to pay their debts with it.

Mr. Reierson, I do not want to interrogate you further on this. I appreciate your answers to the questions, and if you want to elaborate on them when you get the transcript it will be all right to do so.

Without objection, each member of the panel and each member of the committee may do the same thing. They may elaborate on their testimony or their questions or answers and include any germane matter in connection therewith. So that will be done.

I do want to invite your attention, Mr. Reierson, to the fact that the Federal Government is not in distress, but the taxpayers need help, and every dollar saved for the taxpayers we are, of course, all for. And it occurs to me that the Federal Government has been good to commercial bankers, and I think it should be. I am for the commercial banking system I have. I think it is a good one. I think it is about the finest in the world. I am not trying to attack it or hurt it. I certainly do not want to destroy it. And I believe we should have a profitable banking system, because a banking system is not worth much to the people unless it is profitable. Otherwise, it could not serve the needs of the people. So I am for all of these things. I want a good banking system to continue.

But I do not think that the banks should fail to recognize their obligations to Uncle Sam and not require Uncle Sam to pay these debts more than once. And I respectfully invite your attention to the fact that under our present system, we are paying our debts more than once. And there is where the commercial banks can be of help to Uncle Sam, to help devise some way of stopping the payment of these debts more than once. It is just not right.

And I hope, Mr. Reierson, that you give this question consideration. If you come up with any answers, they will be helpful, and, of course, any answer you give will be helpful and constructive. I know this committee will be glad to receive it, and I personally will be very glad to receive it.

Now about the $15 billion in reserves that has been mentioned here that the banks have, under our system—which I am not quarreling with—this $15 billion was not paid by the banks. It was made available to the banks by the Federal Reserve System. It did not cost the banks anything. And the banks use that as a reserve to issue additional credit. Well, in the public interest that is all right. I am not objecting to it. But I do object to the Government paying its debts more than once, and I think that we ought to cancel these debts as they are paid, or as soon thereafter as it is possible to do it without injury or hurt to our economy, and in that way we will have some of our major problems solved, if we can just cancel $15 billion of this debt.

Any other questions, gentlemen?

Representative CURTIS. Yes. Chairman Douglas wanted to ask Mr. Paradiso this question: whether the Government's budget system for calendar 1960, as you have shown it, would contribute to expansion of total demand or contraction, or would it be substantially neutral, in your judgment?

Mr. PARADISO. In terms of the contribution to the gross national product, to the goods and services purchased by the Federal Government, it would be pretty much about the same as in 1959. In other words, no expansion is indicated from the 1959 rate.

In terms of other activities, however, there might be some reduction. There are some reductions involved in loan operations, for example.

So on the whole I would say that very little change is indicated from the 1959 situation, and I think in that sense you can say that it is probably neutral from the purchases side.

On the other hand, from the receipts side, on the basis of assumptions used with respect to the economic picture, the Government is to take in more in revenues than it is going to spend, so in that sense there is—I will not say deflationary, but a somewhat different situation from 1959, when there was a deficit involved.

Representative PATMAN. It is traditional for this committee to hear the Council of Economic Advisers every year after the President has submitted his Economic Report, but in executive session. And tomorrow morning this committee will meet here in this room at 10 o'clock to hear the Council of Economic Advisers.

Tomorrow afternoon the session will be open here in this room, commencing at 2 o'clock, at which time the Chairman of the Board of Governors of the Federal Reserve System, Mr. William McChesney Martin, will be our witness.

Without objection, the committee will stand adjourned subject to the call of the Chair, with meeting tomorrow morning at 10 o'clock.

(By direction of the chairman, the following is made a part of the record:)

STATEMENT FOR THE PRESS BY THE FEDERAL RESERVE BANK OF PHILADELPHIA JANUARY 8, 1960

PREDICTIONS FOR 1960

The flood of economic forecasts issued around the turn of the year has become so overwhelming that the Federal Reserve Bank of Philadelphia has attempted to boil it down to manageable proportions. The bank has compiled and

charted many of the predictions made by businessmen, economists, and Government officials. Its analysis concludes that the year 1960 will see an increase of 6 percent in overall business activity if the typical forecast turns out to be right.

The summary indicates a high degree of agreement that total business activity, as measured by gross national product, will rise by about $30 billion above 1959 to reach a total of $509 billion. Most forecasters are also agreed that prices will rise by about 2 percent.

About $17 billion of the total increase in GNP will be contributed by consumer spending, according to the typical prediction. Spending will increase as incomes rise and unemployment declines to around 3 million. This level of predicted unemployment would be about the same as that in 1955–57. Consumers will spend substantially more for new cars, buying about 7 million in 1960; 500,000 of these are expected to be imports. On the other hand, the market for new houses will shrink. The typical prediction is for 1.2 million houses to be started.

Businesses will spend substantially more for plant and equipment and for inventories. The typical forecast is for total capital spending of $36½ billion. Although considerable, this increase is substantially less than that in 1956. Because of the depletion of inventories during the steel strike, and the generally low level of inventories in relation to sales, businesses will be accumulating inventories at a rate of about $6 billion during 1960. According to the typical forecast, the rate of accumulation will be particularly high early in the year, approximating the rate of the second quarter of 1959.

Government spending is likely to rise by $4 billion. Federal Government spending will play a less important role than in 1959, most of the increase being by States and local governments.

Most forecasters look for strong business in the first half, with a slowing down in the latter part of the year. This kind of prediction has often been made in earlier years, however, and may simply reflect the fact that it becomes harder to forecast the further ahead one is looking. Some of the expected slowdown also reflects declining inventory accumulation as well as the possibility of a recession in 1961.

The bank stresses, however, that the predictions which it analyzed were all made before settlement of the steel strike. It is possible that many forecasters will be raising their sights and that the typical prediction may prove to be an underestimate. Moreover, it seems that forecasts often underestimate the extent of the increase when business activity is rising. An analysis of predictions made a year ago bears this out.

HOW TO USE THESE CHARTS

Shaded areas indicate actual annual figures for 1957, 1958, and 1959 (estimated).

Solid lines show actual trends, quarterly or monthly, during 1957, 1958, and 1959 (partly estimated).

Dots indicate forecasts for the year as a whole and should be compared with shaded areas.

Small x's indicate forecasts for quarters and months within the year and should be compared with the solid lines.

GENERAL

Joseph R. Slevin, national economics editor; Herald Tribune, October 21, 1959: "Growing conviction among Government economists that the business upturn will last longer than would have been the case if there had been no strike. Demands for steel products that would have been met in 1959 now will not be met until the first half of 1960. Result is that the boom has been stretched out. Capital-goods push may be felt when other demand pressures are beginning to subside. Profits in 1960 may have been enhanced."

"Business Trends"; Newsweek, October 26, 1959: "The economy won't recover from the steel strike until sometime in 1960. But the threat of an economic recession or readjustment next year may also have been postponed by the long strike."

FORECASTER AND DATE	GENERAL				CONSUMER				BUSINESS			GOVERNMENT
	SUMMARY	G N P (bil. $)	Industrial Production (1947-49 = 100)	Prices (1947-49 = 100)	Employment (mil.)	Personal Consumption (bil. $)	Auto Sales (mil.)	Housing Starts (mil.)	Business Outlays (bil. $)	Steel Production (mil. net tons)	Profits (bil. $)	Government Outlays (bil. $)
N.I.C.B. Economic Forum (cont.)												
c. Louis J. Paradiso, Asst. Director, O.B.E.	No boom proportions	Rising throughout year		Farm prices drop will partially offset probable rise in industrials		Increase			Inventory accumulation of $6 (was $3.5 in 1959)			
d. Ira T. Ellis, Economist, du Pont Co.				Food prices below 1959		At least $328 - up 5.5%. Nondurables at $153 - up 4%; hit $155 in 4th Q. Services up 6.5%						
e. Malcolm P. McNair, Prof. Harvard University	Reasonably good year, but not a boom year, at least not throughout	Close to $500 during 1st half. Year total about $500		Consumer hit 126.5 by year end. Wholesale steady or down	Unemployment of above 3. 5-6% (s.a.)	Up about 4-5%. Gain in autos greater than other dur. Serv. up 5-6%	6.7-6.8 (was 6.1-6.2 in 1959)	1.1	Inventory accumulation of $6-8, mostly in 1st half		Good	Up, state & local more than Federal
f. A. D. H. Kaplan, Prof. Rollins College	2nd half at slower rate of growth than 1st half	Close to $500 in 2nd Q; hit $515 in 4th Q				Higher						
g. O. Glenn Saxon, Prof. Yale University	Peak year in current business cycle. Best in history	Hit $515 in 4th Q	Peaks in 1st & 2nd Q; 4th Q may be below 2nd Q	Consumer and wholesale up moderately in 1st half, fall back in second	Unemployment about 3	New record			Rate of stock accumulation slower in 2nd half			
h. Jules Backman, Prof. New York University	Activity expanding; best year in history	Hit $500 in 1st half, level off		Wholesale in range of point; consumer up to 127	Unemployment about 3				Sharp rise in stocks in 1st half, slower rate in 2nd			Rise in state & local; Federal neutral
Arthur S. Harper, V. P. Lionel D. Edie Co.; C. & F. Chronicle, 12/3/59	Level of activity will reach a new high in the 1st half of 1960, level off to high even keel during the remainder of the year	$510 - up 6% from $480 in 1959. All major sectors will be higher	Will increase about 8% - 162-164. Gain centered in durables. Durables 176-178 vs. 164 in 1959; nondurables 150-152, up from 143			$328 - up $17. Major gain in services. Durables up $3 due to good 1st half demand for autos and appliances. Nondurables at $154 - up $6. Total will be higher in 2nd half	6.7 domestic - 0.5 foreign	1.15 - down from 1.35 in 1959	Durable equip. at $31 - up $5. Construction at $39.5- down $0.5. Inventory accumulation $7 - up $3 - peaking out in 2nd half. Capital outlays higher in 2nd half	During most, if not all, of first 6 months will be back to peak levels, peaking out in 2nd half. Will be about 130 tons - up from less than 100 in 1959		$102-$103 - up $3-$4. Gain centered in state & local. Federal will change little
Economists, Prudential Insurance Co. of America; 1960 Economic Forecast, 12/7/59		$509 - a gain of $29		Consumer prices will edge upward	Unemployment will decline to about 4% of labor force. High employment	Up $18 from $312. Increase spending on durables		Private - 1.2, down from 1.335 in 1959. Dollar outlays down $1 b.	Capital outlays up $6 to $50. Inventory accumulation of $6, up $2			Federal up about $0.5. State & local up $2.5 to $47. Total of $101.5
Standard & Poor's 1960 Annual Forecast; The Outlook, 12/7/59	New highs in 1960. Strong upsurge early in year; probably give way to leveling tendencies as inventories of steel & related end-items are rebuilt. Advance continue throughout 1960. Long steel strike assured a favorable business climate for 1960	$500 - up 4% from 1959's $480	160 - up 7% from 149 in 1959. Peak of 162 hit before end of year			$323 - up 4% from 1959's $310.3. Durables $45.5 - up 6% from $43; nondurables $151.5 - up 3% from $147.3; services $126 - up 5% from $120	Exceed 1959's 5.3 by at least 20%	Decline due to scarcity of money and high interest rates	$75 - up 4% from 1959's $72. Constr. $41 - up 1% from $40.5; equip. $29 - up 9% from $26.5. Inventory accumulation $5, was $5 in 1959			$101.5 - up 3% from $98.4 in 1959. Federal $55 - up 2% from $54; state & local $46.5 - up 5% from $44.4
Annual Panel Discussion of First National Bank of Chicago; Outlook for Business, 12/8/59												
a. Joseph L. Block, Chairman, Inland Steel Co.	Year looks very good, but unlikely tempo of 1st half will continue unabated throughout entire year						Nearly 7	Down 10%	Capital outlays up	70 tons in 1st half - 93% of capacity. 130 tons for year		
b. Charles H. Kellstadt, Pres. Sears, Roebuck & Co.	Will be year of substantial increase in most areas of the economy		8-9% gain; rate of advance higher than average in 1st half, lower in 2nd half		High level	Good gains for all major groups. Durables, due to steel shortages, may get off to slow start - up 8-10%. Nondurables up 5%. In both rate of gain in 1st half higher than 2nd half		Lower	Up substantially			Up substantially
c. W. C. Newberg, Vice Pres. Chrysler Corp.							7 including 0.5 imports					
National Planning Association; Current Economic Outlook, 12/11/59; Gehard Colm, Looking Ahead, 12/23/59	Question: Can substantial increase in plant & equipment alone insure a satisfactory rate of growth when a tight money policy has a restraining effect on residential construction and some other activities and when a restrictive budget policy puts a close ceiling even on high priority programs?	Up $15-$20 - hit $500 at least, but not $525 (constant dollars)		Probably higher	Employment not likely to reach "full" unemployment rate of 3-4%	Total up. Durables up $2.5		Residential construction off $1.5 bil	Inventories up $2.5. Capital outlays up $3.5			State & local up $2; Federal up $0.5
Newsweek, 12/14/59	A year of great prosperity, although the build-up won't be as rapid as it was before the steel strike in 1959. Bigger business and consumer spending will supply most of the upward thrust	By year's end should hit $525		Rising		High; durables good	7 (including imports) vs. 6.2 in 1959	Less than 1.2 vs. 1959's 1.3 - drop due to tight money	Inventories may add $10	130 vs. 92 in 1959		Up slightly from $98.4 rate of 3rd Q 1959
Daniel B. Suits, Univ. of Michigan; Washington Banktrends, 12/14/59		Up 2% (constant dollars)			Unemployment 4.4 vs. 3.8 in 1959	Up 6% (constant dollars). Auto up 26%			Accumulation but lower than last year			Up 2% (constant dollars)
National Association of Credit Management Survey; Monthly Business Letter, 12/15/59				58% surveyed expected to increase their prices					Half of those surveyed expected to increase plant & equip. outlays		55% surveyed expected improved profits	
Cleveland Trust Company; Business Bulletin, 12/16/59	Carryover of activity from 1959 will stimulate business in general, and the durable goods industries in particular, during the 1st part of 1960. The current upswing probably has enough steam to carry through 1960, though at a slower pace after the post-strike rebound has ended. For the year business as a whole will hit an all-time peak.	$507.3 - up from $479.6 in 1959		Consumer will average 1.5% higher than 1959's 124.6		Durables $47.5 - up from $43 in 1959; nondurables $154 - up from $147.9; services $127.5 - up from $120.4	Production of 6.5-7 vs. 5.5 in 1959	Residential $20.5 bil. vs. $22.1 in 1959. Starts down 10-15% from 1.36 in 1959	Inventory accumulation of $6.3 - was $4.4 in 1959; durable equip. $30.5 vs. $26.3 in 1959; construction $19 vs. $18 in 1959. Accumulation slowdown as year progresses	125-130 tons vs. 92 in 1959		Federal $54.5 vs. $53.8 in 1959; state & local $47.5 vs. $44.4 in 1959
Paul T. Babson, Pres. United Business Service; H.T., 12/16/59	1960 an "up" year, with most business barometers heading for new peaks. Total business volume, stimulated by increased consumer spending, will show considerable improvement over 1959					Durables up 12% and nondurables up 5%	6.8 produced and 0.5 foreign cars sold	Down 10% to 1-2	Inventory accumulation of $6	125 tons - 84% of capacity		

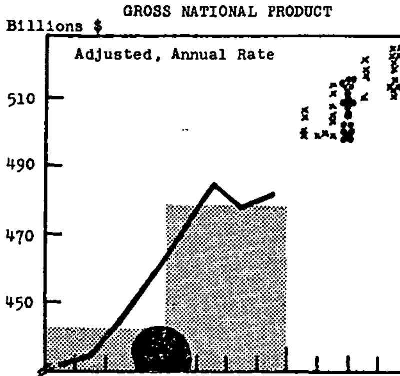
SUMMARY OF BUSINESS FORECASTS FOR 1960

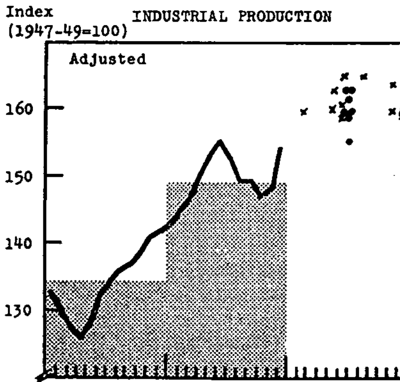
Prepared by the Research Department FEDERAL RESERVE BANK OF PHILADELPHIA January 7, 1960

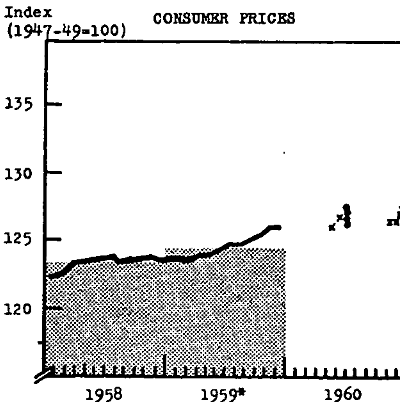
	GENERAL				CONSUMER				BUSINESS			GOVERNMENT
FORECASTER AND DATE	SUMMARY	GNP (bil. $)	Industrial Production (1947-49=100)	Prices (1947-49=100)	Employment (mil.)	Personal Consumption (bil. $)	Auto Sales (mil.)	Housing Starts (mil.)	Business Outlays (bil. $)	Steel Production (mil.net tons)	Profits (bil. $)	Government Outlays (bil. $)
Edwin B. George, Director of Economics, Dun & Bradstreet, Inc.; Boston Conference on Distribution, 10/19/59	The chances of a recession beginning at any time in 1960 are small. Questionable if year as a whole will be a "full employment" one	$510-$515	Hit a high of 166-167 sometime in spring	Except for possibly food, will be higher		Services and nondurables up. Big year for durables	6.5 domestic	Down 10% - 1.22 vs. 1.35-1.36 in 1959. Residential construction dollar volume off.	Inventory accumulation will be substantial; capital outlays around $50; still rising late in year.			Little change in federal. State & local up; but slower than in 1958 and 1959
Business Week, 10/24/59	In 1960, a business surge propelled by frantic inventory rebuilding, high capital spending, hefty auto sales	Hit $500 in 1st Q. - climbing all year				Up, especially durables	Domestic sales of 6.5	Not too certain; 1.1-1.2	Inventories up at least $5 (a.r.) in 1st Q			Federal may be up $1-2; state & local up $3
The Trend of Business; Dun's Review, Oct. 1959	Generally promising business outlook	$500.4-4th Q, 1959; $506.0-1st Q; $508.8-2nd Q; $510.5-3rd Q	Hit June's peak early in year			$322.4-4th Q, 1959; $325.7-1st Q; $328.3-2nd Q; $330.7-3rd Q			Plant & equip. rise in 1st half; moderate increase in inventories in early 1960. $78.5-4th Q, 1959; $79.7-1st Q; $79.4-2nd Q; $78.0-3rd Q			$99.5-4th Q,1959; $100.6-1st Q; $101.1-2nd Q; $101.8-3rd Q.
Forecasting Conference, American Management Assoc. Held 9/28-30/59; The Business Outlook for 1960, Bulletin of Oct. 1959												
a. Fred F. Hoyt, V.P. Carrier Corp.				Relatively stable	High	Most durables up	Domestic sales of 6-7 depending on small car acceptance	1.2 compared with 1.350 in 1959				
b. Thomas O. Boucher, Dir. Johnson & Johnson				Retail up 2%		Nondurables up						
c. George R. Vila, V.P. U.S. Rubber Co.			Up 5%							127 - up from 107 in 1959		
d. Alexander L. Bupp, Asst. to Pres., Bucyrus-Erie Co.	A good year	Over $500 by 2nd Q. Year total about $500		Inflation continued								
Business Advisory Council; Newsweek, 11/9/59	Economy as a whole should prosper; last half decline made less likely by steel strike. Profit squeeze alter plant expansion plans	Hit a high point around $525				Heavy spending	A good year		May not give the economy a boost			Federal held in tight rein
The Outlook, Standard & Poor's, 11/9/59	Greater part of gain recorded in early part of year; later months extending the advance only gradually	Will reach the $500 mark; up $20 from $480 of 1959				Up 4.5%		Decline	Inventories may rise $5 -same as 1959. Durable equipment up 10%	123 - but could be 130 - up almost 40%		Fed. up moderately; state & local more sharply than federal
F. W. Dodge Survey of 273 Economists (taken in summer); Building Business, 11/9/59	Expect a good year, but some tapering off in rate of growth. May have a dip in 1961. Less optimistic than in 1958. (Based on a quick settlement of the steel strike)	Median of $514 by 4th Q (based on $485 in 3rd Q of 1959). 65% expected a rise every Q	Median of 157 in Dec.1959; Rise to 160 in June and level off	Consumer to hit median of 127.0 by Dec. - a gain of 2% from mid-1959. Wholesale up to 121.0 in Dec. - up 1% from June 1959		Median of $325 compared with $311 in 1959		1.25 (a.r.) in 1st half, 1.2, (a.r.) in 2nd half - compared with 1.345 in 1959. Decline due to tight money				
William F. Butler, V.P., Chase Manhattan Bank; Meeting of Petroleum Institute, 11/10/59	General business activity will move ahead in strong fashion in 1960; advance will carry over into 1961 and perhaps well through the year. Rate of advance slower in 2nd half of 1960. Inventory rebuilding will power the expansion through mid-1960, and then plant and equipment will take over and carry prosperity into 1961	Hit $520-$525 in 3rd Q (based on $481 in 3rd Q 1959). Rate of rise slow down in 4th Q	Reach 165 by mid-1960. Peak of 170-175 hit in 1961		Minimum of unemployment	Up $20-25 from 3rd Q 1959 to 3rd Q 1960			Inv. up $6-8 from 3rd Q 1959 to 3rd Q 1960. Plant & equip. up $8 or 18% from 3rd Q 1959 to 3rd Q 1960	At near capacity rates through mid-1960 at least	Very good, perhaps better than most analysts now think	State & local up - but gain smaller than in recent years. 3rd Q 1960 up $2.5 from 3rd Q 1959. Federal has levelled out
University of Michigan's Conference on the Economic Outlook; WSJ, 11/16/59	Generally good business conditions through the 1st half of 1960; level off for rest of year	At least $500; may hit $520 by 4th Q							Inventories up $7 or more; capital spending up			
John J. Haas, V.P., Lionel D. Edie & Co.; J/C, 11/16/59		$510 vs. less than $490 in 1959	Top 160 vs. 148 now					Peak passed			Peak passed	
Dr. Gabriel Hauge, Finance Committee, Manufacturers Trust Co. of N.Y.; U.S. Investor, 11/16/59	The best year in the history of United States; gains throughout most of the year			Inflation problem not too great		Improvement - especially durables			Heavy stock accumulation			State & local above 1959
Agriculture Dept.'s Outlook Conference; H.T., 11/17/59	Moderate rise, but no boom	$500										
a. Louis J. Paradiso, Asst. Dir., OBE	Exceedingly prosperous year but quite uneven				Unemployment will not decline	Rising demand for appliances & furniture	7 incl. foreign	Decline	Most stock gain in 1st half. Plant & equip. up moderately			State & local up - but Federal steady at $54
U. S. Chamber of Commerce, Business Outlook Conference; WSJ, 11/23/59	1960 a modestly prosperous year, but with a slackening of business in the 2nd half. Inventory rebuilding only sector to be outstandingly strong											
Economists for Republic Steel Corp; Steel, 11/23/59		$507-1st Q; $515-2nd Q; $518-3rd Q; $523-4th Q	159-1st Q avg; 163-2nd Q; 165-3rd Q; 164-4th Q									
Consensus of steel experts; Steel, 11/30/59		Average between $510-$520				Appliances above 1959	6.5-7	Off due to tight money		130 tons. Forecasts ranged from 120-140 tons		
National Industrial Conference Board Economic Forum; NICB Business Outlook, 1960 12/3/59	Deceleration may develop in the 2nd half	Average of $505.8-2nd Q & $516-4th Q (was $481.3 in 4th Q 1959) $510-$520 for year; gain mostly physical	Average of 160 in 2nd Q & 160 in 4th Q (was 148 in 4th Q 1959	Consumer price index average of 126 in 2nd Q & 126.5 in 4th Q (was 125.5 in 4th Q 1959) Wholesale price index avg. of 119.7 in 2nd Q & 120.1 in 4th Q (was 119.4 in 4th Q 1959)	Unemployment avg. of 3.2 mil. in 2nd Q & 3.1 mil. in 4th Q (was 3.4 mil. in 4th Q 1959)	End of year will hit $325-$330. Durables -$45; nondurables-$155; service-$125-$130. Durables drop in 2nd half			Equip. $30; inventory accumulation of $4 in 4th Q, rate slower in 2nd half			By 4th Q, $102. Federal $53.5 by 4th Q; state & local at $48.5 in 4th Q
a. Bradford B. Smith, Economist, U.S. Steel Corp.	General levels of industrial production in 1960 will be similar, perhaps better, than those of 1959									125-130 tons; was 90-95 in 1959		
b. George P. Hitchings, Economist, Ford Motor Co.	Sharp advance in early part of year; higher activity in 1st half, leveling off in 2nd half	Hit $500 in early part of 1960				Autos will rise more than other durables; impact felt most sharply in 1st half	7 (includ. imports) was 6.1 in 1959		Inventory rebuilding by durable mfg. & auto dealers rapid. $9-10 (a.r.) in 1st half, drop in 2nd half		Up in 1st half	

FORECASTER AND DATE	GENERAL				CONSUMER				BUSINESS			GOVERNMENT
	SUMMARY	G N P (bil. $)	Industrial Production (1947-49 = 100)	Prices (1947-49 = 100)	Employment (mil.)	Personal Consumption (bil. $)	Auto Sales (mil.)	Housing Starts (mil.)	Business Outlays (bil. $)	Steel Production (mil. net tons)	Profits (bil. $)	Government Outlays (bil. $)
P. Henry Mueller, V.P., First National City Bank of N. Y.; C. & F. Chronicle, 12/24/59	Accumulation of inventories will add to the sharpness of the upswing in early 1960					Rise	Up	1.2 - down 10-15% from 1959				Federal relatively stable; state & local slightly rising
B.W., 12/26/59	Will be a year of record activity; strong 1st half pu [illegible]	$502 - 1st Q; $513 - 2nd Q; $519 - 3rd Q; $525 - 4th Q. Avg. - $515 - up 7% from $480 in 1959				Up $7 (a.r.) in each of 1st 2 Q of 1960. Will rise in 2nd half, but at lower rate	Highest in history. 7.25 incl. foreign	Down 14% to 1.15; 1.33 private in 1959	Stock accumulation of $8 (a.r.) in 1st half. Capital outlay big rise later in year	Top 70 tons in 1st half. Year output of 130		Federal steady; state & local up $3
J. A. Livingston's Survey of Economists; Bulletin, 12/27/59	1960 going to be prosperous. Some expect a slow-down in 2... half	$505 - 2nd Q; $512 - 4th Q ($479 - 4th Q, 1959)	159 - June; 160 - Dec. (148 - Nov. 1959)	Wholesale: 120.5 - June; 121 - Dec. Consumer: 126.7 - June; 127.4 - Dec.	Unemployment: 3.5 - June; 3.5 - Dec. (3.7 - Nov., 1959)			1.145 (private, s.a., a.r.)-June; 1.130-Dec. (1.210 - Nov., 1959)				
Department of Commerce's Survey of Industries; J.C, 12/29/59	Higher levels of economic activity in virtually all sectors						Production of 6.7 vs. 5.5 in 1959			125 tons		
American Economic Association Convention; H.T., 12/29/59; J/C, 12/29/59	Majority expect 1960 to be year of relatively "full employment" in which both overall business activity and prices will rise substantially. Half think 2nd half will level off at 1st half rates			About 80% said consumer prices will rise more than 1%	80% thought "full employment" - unemployment of 3.0							
a. Paul McCracken, Economist, University of Michigan		Up $30 or 5%		Consumer up about 2%	Unemployment rate of 4% or less	Up $18-20		Drop in dollar volume of residential constr. Starts off	Inventory accumulation of $7. May turn out to be "sleeper"			Up $5, mostly at state & local level
U.S.News, 1/4, 60	Best year ever. Most of rise in 1st half, due to inventory accumulation	Up 5% - $25 or more. May level in 3rd Q and dip a bit in 4th Q Most of rise physical	End of 1960 will be 159 (150 at end of 1959)	Relatively stable	At end of 1960, employment at 69.8 (68.4 at end of 1959). Unemployment 2.9 (3.6 at end of 1959)	Will be $330 by end of year ($316.5 in 4th Q, 1959). Durables-$79.4 by end of 1960 ($74 in 4th Q, 1959). Nondurables-$152 by end of year ($145 in 4th Q, 1959) Services-$130 at end of year ($124 in 4th Q, 1959)	7.1, incl. imports	1.1 (s.a., a.r.) end of 1960. Was 1.2 at end of 1959	Equip. to hit $29.9 in 4th Q ($26.3 in 4th Q, 1959). Sharp rise in inventories in 2nd Q		$25.5, after taxes, in 4th Q ($23.6 in 4th Q, 1959). Before taxes will be $49.7 in 4th Q ($46 in 4th Q 1959)	Federal down to $53.1 in 4th Q (was $53.7 in 4th Q, 1959). State & local hit $45.7 in 4th Q (was $44.4 in 4th Q, 1959)
N.I.C.B. Business Record, Dec. 1959	A violent catch-up period in 1960, occurring in a generally mature business environment, and with unhealthy overtone suggested by statistics. A large number of analysts seemed to be writing off 1960 as an over-stimulated boom. Activity at record levels in 1st half								Substantial accumulation of stocks		Expected to return to their pre-strike rate of $53 (a.r.) and might well exceed this figure for a time	
Survey of Business Executives; Nation's Business, Dec. 1959	1960 will be a rewarding year for business. 84% surveyed thought money and credit market would have no effect on their plans for 1960			65% surveyed expect their prices to remain at present levels; 31% forecast a rise					57% surveyed have reached min. stocks for sales expected. 43% to spend more for expansion		58% surveyed expected profit per sales dollar to be unchanged; 28% expected a rise	
Business Roundup; Fortune, Dec. 1959	In the 1st half of 1960 the economy will be striving to make good the total loss of $5 bil., and if it does so, the annual rate of GNP will rise by at least $10 billion, over and above the prosperity level that was in prospect for 1960 before the strike started. That would stretch the limits of the economy's capacity. Most of "catch-up" output will be ticketed for inventories	To make up strike losses, would have to hit $515 next spring	To make up strike losses, would have to reach 165-170 next spring				7-7.5 incl. foreign		Business executives expect only a 1.5% rise in stocks over the next 12 months. Capital outlays seem headed for new records. Now running close to $46			
Royal Plenty, Financial Editor, Phila. Inquirer; Summation of Predictions for 1960; Inquirer, 1/3/60	Most economists see economy climbing right through 1960, although a large number caution against a mid-year downturn after the steel and metal-using industries have rebuilt their inventories. Worries were tight money, labor troubles, lower farm income, worsening of competitive position of our products and rising costs	Crossing the $500 mark	Rising to a new high			Record	Record. Some auto industry analysts are revising upward their early estimates of 7 (incl. 0.5 imports)	Decline due to tight money		Approach a record of 130 tons		State & local rise to counterbalance slight dip in Federal.

OVER-ALL OUTLOOK





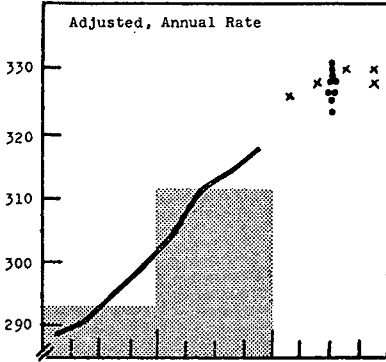


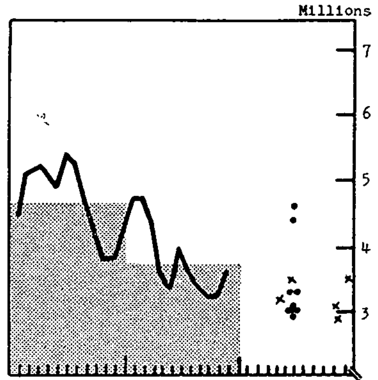
*Year, fourth quarter, and December estimated

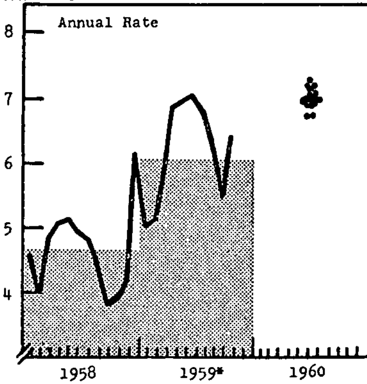
• Average for the year

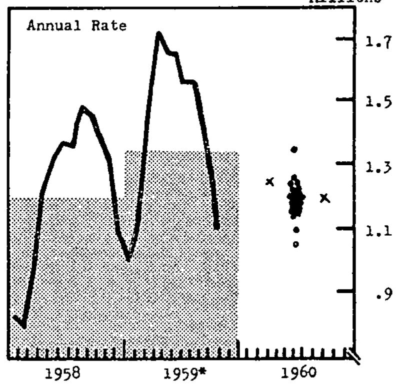
x Month, quarter, or half

Consumer







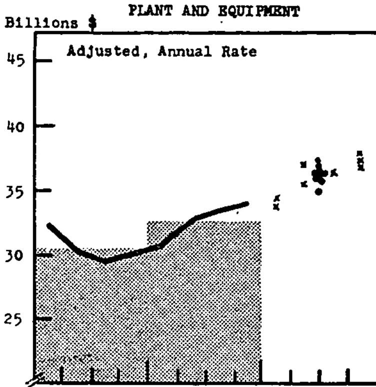


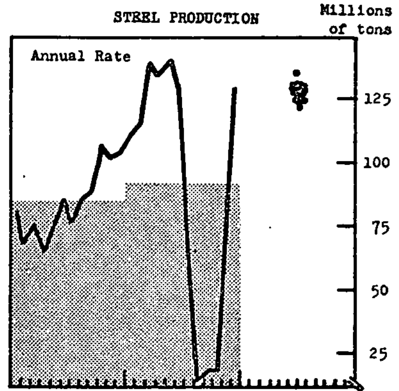
*Year, fourth quarter, and December estimated

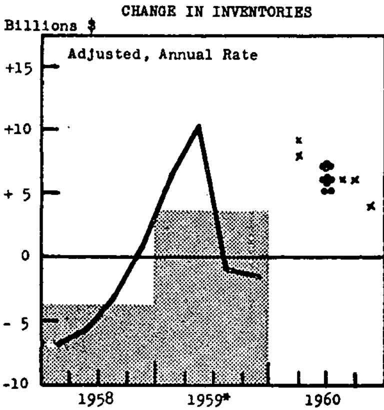
• Average for the year

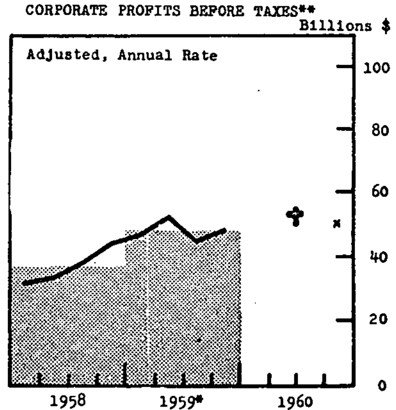
x Month, quarter, or half

BUSINESS







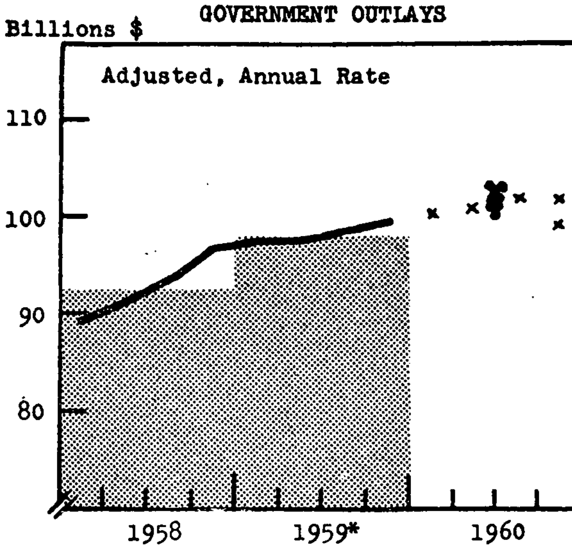


*Year, fourth quarter, and December estimated

**Third and fourth quarters, 1959, estimated

● Average for the year

X Month, quarter, or half

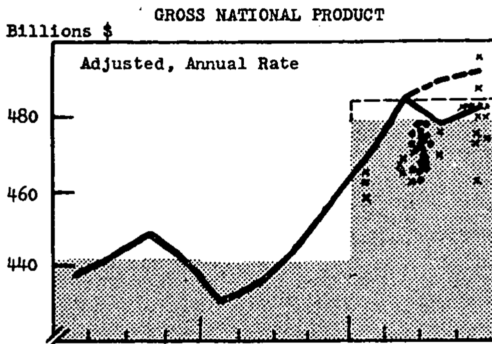


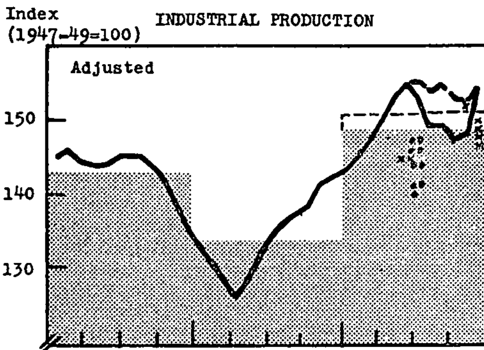
*Year and fourth quarter estimated

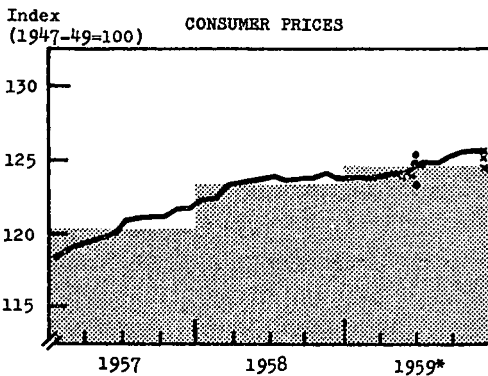
• Average for the year

x Quarter or half

PREDICTIONS FOR 1959







*Year, fourth quarter, and December estimated

• Average for the year

× Month, quarter, or half

▬ ▬ G.N.P.: without steel strike (estimate)
Industrial Production: excluding primary metals and metal fabricating industries

Sylvia F. Porter; Daily News, October 30, 1959: "Duration of the upswing presumably has been prolonged because so much of what would happen in 1959 will take place in 1960. Examples—automobile sales and corporate profit."

"Government Economists"; Wall Street Journal, October 30, 1959: "Strike delayed business rebound, not hurt it permanently. Expansion to continue throughout 1960. GNP to near $500 billion rate early in year. See poststrike rush to build inventories; expect record personal income and corporate profits."

"The Outlook"; Wall Street Journal, November 2, 1959: "The question as to 1960 is whether the portions of business that have been good are using up some of their steam now, while those which have been poor and are getting worse will pick up when some of the steam may be out of those now doing well. If so, we might see the full upsurge in hard goods, which had been expected later this year and early next year, postponed to next spring and summer. And we might see the full upsurge in capital spending, which had been expected early next year, postponed to late 1960. The net result might be a longer sustained period of relatively good business, but with a lower peak."

Consensus, National Association of Business Economists; Journal of Commerce, November 9, 1959: "Outlook is good, but no roaring boom is in sight. The latter part of the year is likely to witness some leveling off in business, although any important downturn may be deferred until 1961."

V. Lewis Bassie, director, University of Illinois Bureau of Economics and Business Research; Herald Tribune, November 17, 1959: "Business situation in 1960 very unstable. Activity will hit a high early that quickly will give way to a recession."

Steel, November 23, 1959: "Consensus is a steep, steady climb to new highs during the first half. The rate of ascent will decline in the third quarter, followed by a leveling off in the final period of 1960. Biggest weak spots will be construction—specifically housing—and tight money."

Arthur Rosenbaum, manager of economic research, Sears, Roebuck & Co.; Steel, November 23, 1959: "Good year, but a leveling off in many indexes can be anticipated before the end of 1960."

Serge Klotz, MacKay-Shields Associates, Inc.; Steel, November 23, 1959: "Resumption of the business boom, led by the automobile industry and industrial equipment and with an assist from appliances."

O. Glenn Saxon, professor of economics, Yale University; Commercial and Financial Chronicle, November 26, 1959: "The long continuation of the steel strike in 1959 will assure generally higher levels of activities in 1960. Practically all industries will register new peaks of production. Boom stage can be expected to continue into 1961 unless inventories are overbuilt and prices of products increased unreasonably."

The Morgan Guaranty Survey, November 1959: "Prospects excellent for a continuing advance in general business levels at least until the middle of 1960. Steel users will seek to rebuild inventories, and this task cannot be achieved until late spring at the earliest. The evident willingness of consumers in general to spend freely from income is also a buoyant factor. There is a widespread feeling that 1960 could be a highly successful year for automobile industry. Higher mortgage rates may cause a tapering off in residential building, but this could be offset by higher outlays for commercial and industrial construction. In brief, it may well be that for some time into 1960 the greater danger, as far as general economic activity is concerned, will lie in too much demand rather than too little, particularly if the steel settlement ultimately arrived at engenders new inflationary expectations."

Paul McCracken, professor, University of Michigan; Bulletin of Robert Morris Associates; November 1959: "The vigorous expansion of business activity beginning in the early part of 1958 should extend well into 1960, carrying us to a $500 billion economy early in the year. It is probable that the pace of the advance will be somewhat slower than during the last 18 months. There are forces currently visible in the economy that could produce a downturn by the middle or latter part of 1960, although these forces are not yet irresistible. Drag on economy will be declining residential construction outlays, inventory accumulation slowdown as year progresses, and net outflow of dollars. Forces that could produce downturn: Pressures in the money and capital markets may develop to the point where they impede the financing of capital outlays and possibly the purchase of consumer goods. Other factor is the pressure on our price level."

First National City Bank Monthly Letter, November 1959: "General expectations are that the initial upsurge in business activity—based largely on the temporary stimulus of recovery from the strike—will give way to a high-level plateau, or more gradual advance, for the rest of 1960."

Solomon Fabricant, director, National Bureau of Economic Research, Inc.; NICB Business Outlook, 1960, December 3, 1959: "Continuation of expansion into 1960, at perhaps a somewhat slower rate than in the past."

Dr. Roy L. Reierson, vice president and chief economist, Bankers Trust Co.; Wall Street Journal, December 7, 1959: "Significant rise in business activity in 1960, justifying the FRS's continuing to keep a fairly tight rein on the credit supply."

Leonard Lempert, Statistical Indicator Associates; Journal of Commerce, December 28, 1959: "If poststrike activity gets out of hand, as it did after 1956 strike, a major downturn could start before 1961. Meanwhile, he suggests planning ahead on the basis of a 1959 to 1960 increase of 6 percent."

GROSS NATIONAL PRODUCT

Business Trends; Newsweek, October 26, 1959: "A $500 billion economy sometime early in 1960."

Council of Economic Advisers; Wall Street Journal, October 27, 1959: "Predicts that GNP will top $500 billion mark sometime in first half—assuming no steel strike in 1960."

Government Economists; Herald Tribune, October 30, 1959: "Will roar past the $500 billion mark well before mid-1960 and will hit a new peak of $525 billion in fourth quarter."

Administration Forecast; Business Week, October 31, 1959: "A rise to $505 billion or so compared with about $480 billion in 1959. Year will end on rising trend."

O. Glenn Saxon, professor of economics, Yale University; Commercial & Financial Chronicle, November 26, 1959: "Reach between $505 of $510 billion."

Roy L. Reierson, vice president, Bankers Trust Co.; NICB Business Outlook, 1960, December 3, 1959: "$510 billion."

James J. O'Leary, director of economic research, Life Insurance Association of America; Herald Tribune, December 10, 1959: "Will hit nearly $525 billion in the last part of 1960."

Dexter M. Keezer, vice president, McGraw-Hill Publishing Co.; Commercial & Financial Chronicle, December 24, 1959: "About $515 billion; will hit $500 billion mark shortly after New Year's."

Frederic Mueller, U.S. Secretary of Commerce; Herald Tribune, January 1, 1960 very unstable. Activity will hit a high early that quickly will give way to levels a year from now."

PRICES

Wall Street Journal, October 6, 1959: "Food prices probably will help hold down living costs for the next couple of years. Food will head up again next summer—hit seasonal peak in July."

Government economists; Herald Tribune, October 26, 1959: "No uproaring round of price increases, but stick to midsummer forecast that living costs will climb more than 2 percent in 18 months ending December 31, 1960."

Sylvia F. Porter; Daily News, November 5, 1959: "Probability that consumer prices will be up 1.25 to 1.50 percent in 1960."

Arthur Rosenbaum, manager of economic research, Sears, Roebuck & Co.; Steel, November 23, 1959: "Price creep-up in services, construction and commodities."

Franklin J. Lunding, chairman, Jewel Tea Co., Inc.; Outlook for Business, First National Bank of Chicago, December 8, 1959: "Food prices will not decline in the near future as much as they have in the past year."

Wall Street Journal, December 29, 1959: "Commodity prices probably will slide further in 1960. Falling farm prices will more than offset increases in industrial commodities."

Journal of Commerce, December 30, 1959: "Consumer prices are almost certain to rise in the year 1960. Driving force will be services."

National Securities and Research Corp.; 1960 Outlook, December 1959: "Consumer Price Index will be 127 in 1960, compared with 124.5 in 1959."

EMPLOYMENT AND UNEMPLOYMENT

Gerhard Colm, economist, National Planning Association; Wall Street Journal, November 16, 1959: "Unemployment could be 4 to 5 percent of the work force during 1960. Modest increase in employment."

Nathan Koffsky, Deputy Administrator for Economics, Agricultural Marketing Service; Herald Tribune, November 17, 1959: "Unemployment will average about 500,000 less than 1959 average.

V. Lewis Bassie, director, University of Illinois Bureau of Economists and Business Research; Herald Tribune, November 17, 1959: "Unemployment will rise between 0.5 million and 1 million in 1960."

Government economists; Bulletin, December 27, 1959: "Year's high level of activity not quite good enough to bring unemployment below the 3 million level, seasonally adjusted."

National Securities and Research Corp.; 1960 Outlook, December 1959: "Unemployment of 3.3 million in 1960, down from 3.8 million in 1959."

PERSONAL CONSUMPTION EXPENDITURES

Dr. Thomas Gies, economist, University of Michigan; Wall Street Journal, November 16, 1959: "Durable goods spending will be a record of $45 billion in 1960."

Arthur Rosenbaum, manager of economic research, Sears, Roebuck & Co.; Steel, November 23, 1959: "All segments of retail trade will grow, with the greatest gains in durable goods."

James J. Bliss, assistant to vice president, National Retail Merchants Association; Journal of Commerce: November 24, 1959: "Retail sales will continue to rise during first half. Increase will range about 2 to 3 percent over corresponding 1959 period, with gain shared equally by both hard and soft lines."

Iron Age, November 26, 1959: "Personal spending is expected to set new records in 1960."

Business Week, November 28, 1959: "Retail sales will reach about $230 billion, some 5 to 7 percent ahead of this year, with about every segment sharing."

Business Week, December 26, 1959: "Retail sales will be 5 to 7 percent higher in 1960."

J. A. Livingston's Survey of Economists; Bulletin, December 26, 1959: "Retail sales of $19 billion, s.a., in June and $19.4 billion in December. Were $18.1 billion in November 1959."

George P. Hitchings, economist, Ford Motor Co.; Journal of Commerce, December 29, 1959: "Consumer spending will follow rather than determine changes in total business activity in the second half of 1960."

Paul McCracken, professor, University of Michigan; Journal of Commerce, December 29, 1959: "University of Michigan's survey of consumers' buying plans shows that consumers' long-range confidence remains unimpaired and it seems probable that purchases of durable items by consumers should rise about as rapidly as their incomes—perhaps very strongly if the steel strike is settled quickly."

Royal Plenty, financial editor, "Summation of Predictions for 1960"; Inquirer, January 3, 1960: "Helped by automobile industry, retail sales are expected to hit a record of $230 billion—up 5 to 7 percent from 1959."

U.S. News & World Report, January 4, 1960: "Retail sales will be at a seasonally adjusted annual rate of $231.5 billion at the end of 1960. Were $219 billion at end of 1959."

INCOME

Thomas O. Boucher, director, Johnson & Johnson; forecasting conference, American Management Association; Business Outlook for 1960, bulletin of October 1959: "Disposable income of $355 billion, a.r., by the middle of 1960 (forecast made in September)."

Standard & Poor's, the Outlook, November 9, 1959: "Personal income up 4 to 5 percent."

Wall Street Journal, November 11, 1959: "Farm income down—perhaps about half as much as 1959's 15 percent drop."

Arthur Rosenbaum, manager of economic research, Sears, Roebuck & Co.; Steel, November 23, 1959: "Consumer income will be 5 to 6 percent higher than in 1959."

Business Week, November 28, 1959: "Consumer income after taxes should easily exceed $350 billion for a gain of 5 to 6 percent."

Ira T. Ellis, economist, E. I. du Pont de Nemours & Co.; NICB Business Outlook, 1960, December 3, 1959: "Personal income will be at least $400 billion—up 5 percent from 1959. Disposable personal income may also be up 5 percent."

Malcolm P. McNair, professor, Harvard University; NICB Business Outlook, 1960, December 3, 1959: "Increase of 4.5 percent with some decline in farm income."

Jules Backman, professor, New York University; NICB Business Outlook, 1960, December 3, 1959: "Increase of 4.5 percent with some decline in farm income.

Franklin J. Lunding, chairman, Jewel Tea Co., Inc.; Outlook for Business, First National Bank of Chicago, December 8, 1959: "In first half, disposable personal income might average 5 percent higher than in first half of 1959."

"Industry trends in 1960;" the Fortnightly Commentary, December 14, 1959: "A 5.6 percent gain in disposable income."

Cleveland Trust Co.; Business Bulletin, December 16, 1959: "Personal income will show a 5 to 6 percent gain over the 1959 figure of about $380 billion."

Business Week, December 26, 1959: "Disposable income will be up $9 billion in first quarter, and another $9 billion in the second (a.r.)."

Business Week, December 26, 1959: "Personal income will increase 6.4 percent from 1959 to $406.7 billion."

Royal Plenty, financial editor, "Summation of Predictions for 1960;" Inquirer, January 3, 1960: "Disposable income to rise 5 percent to $328 billion with wage and salary owners, stockholders, and bond owners, all sharing in the gains.

U.S. News & World Report, January 4, 1960: Personal income as a seasonally adjusted annual rate of $400.2 billion at end of 1960. Was $384.5 at end of 1959."

AUTOMOBILE SALES

Journal of Commerce, October 5, 1959: "7 million (including 500,000 foreign).

Business Week, October 31, 1959: "7 million (including foreign)."

H. E. Churchill, president, Studebaker–Packard Corp.: Journal of Commerce, November 6, 1959: "Production the same as 1959's 6.6 million."

Automotive industry economist University of Michigan's Conference on the Economic Outlook; Wall Street Journal, November 16, 1959: "Less optimistic than industry executives; forecast between 6.3 and 6.7 million, compared with an estimated 6.2 million (including imports) in 1959.

William C. Flaherty, director of business research, Chrysler Co.; Herald Tribune, November 19, 1959: "Sales of domestic and foreign cars above 7 million."

"Industry Trends in 1960"; the Fortnightly Commentary, December 14, 1959: "6.5 million manufactured."

L. L. Colbert, president, Chrysler Corp.; Steel, December 21, 1959: "Sales will reach and probably exceed 7 million units, including imports. Long steel strike pushed a substantial volume of automobile production into 1960."

Frederic G. Donner, chairman, General Motors Corp.; Herald Tribune, December 22, 1959: "Auto sales of 7 million, including 0.5 million imports."

HOUSING STARTS

U.S. Savings & Loan League; Journal of Commerce, October 12, 1959: "Will approach 1.2 million compared with more than 1.3 million in 1959."

W. R. Wilkinson, vice president, Johns-Manville Corp.: Wall Street Journal, October 14, 1959: "Expected to drop about 9 percent from 1959 estimated total of 1,380,000. Retarded by high interest rates and a 'money shortage.' "

Norman Mason, Housing Administrator; Wall Street Journal, October 23, 1959: "Would not predict 1960 private starts other than to say they would be more than 1 million. Growing scarcity of funds would have an effect. One industry specialist said that on an economic basis, private starts could hit 1.4 million, but that they would not be much more than 1.075 million."

Melvin Baker, chairman, National Gypsum; House and Home, October 1959: "A slight decline from 1.3 million of 1959 due to rising interest rates and tight money."

Value-line investment survey; House and Home, October 1959: "Looks for a drop to 1.15 million."

Consensus, National Association of Business Economists; Journal of Commerce, November 9, 1959: "In absence of fresh Government stimulus, might drop

below 1.2 million—possibly to as low as 1.1 million, compared with 1.35 million in 1959."

George Cline Smith, vice president, F. W. Dodge Corp.; Wall Street Journal, November 9, 1959: "1.25 million, down 10 percent from 1959's 1.39 million."

Walter E. Hoadley, Jr., treasurer, Armstrong Cork Co.; speech, National Building Material Distributors Association Convertors, November 17, 1959: "No more than 1.2 million compared with more than 1.3 million in 1959. Will follow an irregular, downward trend, chiefly because of reduced availability of funds."

Business Week, November 21, 1959: "Homebuilding industry sees drop of 15 percent in activity if tight-money policy persists."

Saul B. Klaman, director of research, National Association of Mutual Savings Banks; Steel, November 23, 1959: "Starts in 1960 will be about 15 percent below 1959's 1.4 million (private and public)."

Nathaniel Rogg, economist, National Association of Home Builders; Wall Street Journal, November 27, 1959: "About 1.2 million—off 11 percent from estimated 1.35 million in 1959."

James J. O'Leary, director, economic research, Life Insurance Association of America; Business Week, November 28, 1959: "1.2 million due to tight money."

Government Housing Experts; Business Week, November 28, 1959: "1.1 million to 1.2 million private starts as compared with a near-record 1.3 million in 1959."

Fortune Forecast; House & Home, November, 1959: "1960 starts 1.35 million, down slightly from 1959."

Miles Colean, economist; House & Home, November, 1959: "1.27 million starts, down 115,000 from 1959."

House & Home, November, 1959: "Reflection of the money situation in the rate of starts will be seen throughout 1960. The money shortage at the end of 1959 probably means a drop in starts in the first half of the year. But easier money in the winter and early spring should lead to a pickup of more than seasonal size in the second half."

Department of Commerce; New York Times, December 2, 1959: "1.2 million private starts—down from 1.325 million in 1959. Decline due to tight supply of loan money."

Home Builders; Newsweek, December 7, 1959: "Decline of 200,000 from 1959's 1,350,000."

Consensus, National Association of Home Builders' Outlook Conference; Wall Street Journal, December 8, 1959: "Private starts to drop to between 1.1–1.2 million, compared with better than 1.3 million in 1959. Drop due to scarcity of mortgage money at rates than can be afforded. Low-cost homebuilder to be hit the hardest."

Industry Trends in 1960; The Fortnightly Commentary, December 14, 1959: "Starts will be down 15 percent due to mortgage money scarcity."

Kenneth G. Heisler, managing director, National League of Insured Savings Associations; Bulletin, December 26, 1959: "Decline from 1.34 million private dwellings in 1959 to about 1.15 million in 1960."

Arthur Desser, president, Lefcourt Realty Co.; Bulletin, December 26, 1959: "Minimum demand for 1.3 million houses."

Robert W. Lear, director of Marketing Services, American Radiator Corp.; U.S. News & World Report, January 4, 1960: "1.2 million."

PLANT AND EQUIPMENT EXPENDITURES

Business Week, October 24, 1959: "Up strongly—possibly 15 percent—above 1959; may hit $40 billion."

Business Trends; Newsweek, October 26, 1959: "The combination of somewhat lower profits and high interest rates may offset expansion plans in 1960."

Alexander L. Bupp, assistant to president, Bucyrus-Erie Co.; Forecasting Conference American Management Association; The Business Outlook for 1960, Bulletin for October 1959: "Spending in 1960 could exceed the 1957 high of $37 billion (forecast in September)."

Frederic H. Mueller, Secretary of Commerce; Wall Street Journal, November 2, 1959: "Will rise but not as rapidly as in 1959."

McGraw-Hill Survey of Business Intentions; Journal of Commerce, November 13, 1959: "Will be $37.3 billion compared with $33.9 billion in 1959. Steel strike is likely to have resulted in stretching the capital spending boom over a

longer period. Manufacturers to increase spending by 19 percent, presumably will be concentrated on equipment."

Dr. Gabriel Hauge, finance committee chairman, Manufacturers Trust Co. of New York City; U.S. Investor, November 16, 1959: "Up maybe 10 to 15 percent from early fourth quarter, 1959, estimates."

Journal of Commerce, November 17, 1959: "Spending by corporations may exceed $30 billion, compared with $28 billion in 1959."

Albert T. Sommers, National Industrial Conference Board; Journal of Commerce, November 18, 1959: "Should be substantially higher than in 1959. In the favorable atmosphere that is likely to prevail in early 1960, the present uptrend in capital outlays by business may well accelerate. Possibly, by midyear major industries will be spending larger amounts for increasing capacity than at any time since 1957. Outlays for equipment and modernization should be in record volume."

William F. Butler, vice president, Chase Manhattan Bank; Herald Tribune, November 19, 1959: "May jump a 'startling' 30 percent from last quarter of 1959 to last quarter of 1960."

Iron Age, November 26, 1959: "Some observers believe they will top the record $37 billion of 1957."

Consensus of Steel Experts; Steel, November 30, 1959: "Over $38 billion versus $32 billion in 1959."

F. W. Dodge Survey of Economists; Building Business, November 1959: "Median of $36.5 billion, an increase of almost 10 percent over $33.3 billion for 1959."

Louis J. Paradiso, assistant director, OBE; NICB Business Outlook, 1960, December 3, 1959: "Increase per quarter of $1 billion, reaching an annual rate of $37.5 billion in fourth quarter and $36 billion for year."

Jules Bachman, professor, New York University; NICB Business Outlook, 1960, December 3, 1959: "Up only 8–9 percent, due to some decline in general sentiment as to the business situation to set in after midyear."

O. Glenn Saxon, professor, Yale University; NICB Business Outlook, 1960, December 3, 1959: "Rise substantially but not hit level of 1959."

Jules Bachman, professor, New York University; NICB, Business Outlook, 1960, December 3, 1959: "Rise throughout the year."

Newsweek Survey conducted by NICB; Journal of Commerce, December 8, 1959: "Expansion appears in the making, but probably less steep and more prolonged than the 1957–58 capital spending boom. Present expansion will probably extend at least into the second half of 1960."

Department of Commerce; Business Week, December 12, 1959: "Outlays in first quarter estimated at $34.4 billion (s.a., a.r.). This would be 15 percent above the 1959 average and $0.5 billion above fourth quarter of 1959."

Daniel B. Suits, University of Michigan; Washington Banktrends, December 14, 1959: "Up 10 percent (constant dollars)."

Gerhard Colm, chief economist, National Planning Association; Journal of Commerce, December 21, 1959: "Up $3.5 billion."

National Securities and Research Corp.; 1960 Outlook, December 1959: "Will be $36.7 billion compared with $32.7 bililon in 1959."

P. Henry Mueller, vice president, First National City Bank of New York; C. & F. Chronicle, December 24, 1959: "Rise probably will be higher than the 19 percent forecast by McGraw-Hill survey."

Business Week, December 26, 1959: "Outlays in 1960 will top 1959's level by something closer to 15 percent than the 10 percent now planned."

J. A. Livingston's Survey of Economists; Bulletin, December 27, 1959: "Will be $37 billion (s.a., a.r.) in second quarter and $38 billion in fourth quarter. Were $34 billion (s.a.,a.r.) in fourth quarter 1959."

NICB Business Record, December 1959: "A 10 percent increase over the 1959 rate of $33 billion. Even this estimate implies a rate of outlays in late 1960 about equal to the previous peak, and it is widely expected that the 10 percent increase will be substantially exceeded, as new spending plans form and mature under the influence of high levels of business activity."

U.S. News & World Report, January 4, 1960: "At a seasonably adjusted annual rate of $37.4 billion at end of 1960. Were $34 billion at end of 1959."

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CONSTRUCTION

Business Advisory Council; Newsweek, November 9, 1959: "Outlook affected by probable drop in residential volume. Overall volume won't exceed 1959's $54 billion."

George Cline Smith, F. W. Dodge Corp.; Wall Street Journal, November 9, 1959: "Contracts in 1960 down slightly from 1959 record. Decline in home construction, due primarily to builders' difficulty in financing new homes, will offset gains in other types of construction. Total off 1 percent from 1959."

Consensus of steel experts; "Steel," November 30, 1959: "Commercial and industrial building up. Highway may be down."

F. W. Dodge survey of economists; "Building Business," November 1959: "Modest increase, a rate of $56 billion in both halves."

Department of Commerce; New York Times, December 2, 1959: "Physical volume of building in 1960 will match the 1959 record. Home and highway building will be down, but schools and commercial and industrial projects will be up. Estimated at $55.3 billion compared with $54 billion in 1959. Will be a stabilizing, not an expansionary, force."

Martin R. Gainsbrugh, economist, National Industrial Conference Board; NICB "Business Outlook, 1960," December 3, 1959: "Private at $41 billion at end of year, same as end of 1959."

Journal of Commerce, December 7, 1959: "Construction spending, following a bulge in the first half, will decline during the second half. For 1960 as a whole, will do well to equal the 1959 total, and may be a little smaller."

James C. Downs, chairman, Real Estate Research Corp.; "Outlook for Business," First National Bank of Chicago, December 8, 1959: "Construction in first half of 1960 will be 6.6 percent below corresponding 1959 period."

Charles H. Kellstadt, president, Sears, Roebuck & Co.; "Outlook for Business," First National Bank of Chicago, December 8, 1959: "Activity in other areas of construction will largely offset the decline in private residential expenditures."

Industry Trends in 1960; "The Fortnightly Commentary," December 14, 1959: "Hold close to 1959 level of $54 billion."

Daniel B. Suits, University of Michigan; "Washington Bank Trends," December 14, 1959: "Residential construction down 1 percent (constant dollars)."

Paul Babson, president, United Business Service; Herald Tribune, December 16, 1959: "Alltime high of about $55.5 billion."

Royal Plenty, financial editor, Summation of Predictions for 1960; Inquirer, January 3, 1960: "Approach $56 billion compared with $54 billion in 1959, despite drop in housing starts."

U.S. News & World Report, January 4, 1960: "Decline in residential offset in part by an increase in industrial building and by moderate gains in warehouses and office buildings."

Robert W. Lear, director of marketing services, American Radiator Corp.; U.S. News & World Report, January 4, 1960: "Total of $55.5 billion in 1960."

CORPORATE PROFITS

Business Week, October 24, 1959: "Profits in 1960 higher than 1959's $50 billion, according to Government economists. Things look good for 1960. In fact, there may be a bulge. Any decline that's suffered in 1959 may be compensated by the pushing of next year's profits to an abnormal level."

Journal of Commerce, October 27, 1959: "Prospects for 1960, especially in first half, have been made considerably brighter by the prolongation of steel strike. Pretax profits likely to reach and surpass $50 billion level during first half of 1960."

Prentice-Hall report on business; Steel, November 23, 1959: "Will be between $52.5 billion and $56 billion before taxes and after taxes about $26.8–$28.6 billion. In 1959 were between $46.5 and $49.0 billion, before taxes, and between $24 billion and $25.1 billion after taxes."

Survey of credit and financial executives, National Association of Credit Management; Journal of Commerce, December 15, 1959: "Of those surveyed, 55 percent looked for higher profits."

National Industrial Conference Board survey of manufacturing executives; Journal of Commerce, December 21, 1959: "Of those surveyed, 67 percent predicted that their profits before taxes for the first half of 1960 will be larger than those earned during the first half of 1959."

Journal of Commerce, December 22, 1959: "Reach a new high record in 1960. Profits after taxes at a level of $27 billion seems to be a reasonable expectation for 1960."

National Securities & Research Corp.; 1960 Outlook, December 1959: "Profits before taxes will be about $54 billion in 1960 compared with about $48 billion in 1959."

Standard & Poor's, the Outlook, January 4, 1960: "After taxes profits point to a new all-time peak. Expected to exceed $27 billion, compared with an estimated $23.6 billion in 1959, an increase of 15 percent."

FOREIGN TRADE

O. Glenn Saxon, professor, Yale University; NICB Business Outlook, 1960, December 3, 1959: "Export surplus of $3.8 billion."

Louis J. Paradiso, assistant director, OBE; NICB Business Outlook, 1960, december 3, 1959: "Net exports of $1 billion (GNP basis)."

Martin R. Gainsbrugh, economist, National Industrial Conference Board; NICB Business Outlook, 1960, December 3, 1959: "Plus factor of about $1–$2 billion in the GNP."

Economists, Prudential Insurance Co. of America; 1960 Economic Forecast, December 7, 1959: "Moderate improvement of about $1 billion in position."

National Planning Association; Current Economic Outlook, December 11, 1959: "An increase in net exports of $1.5 billion."

Newsweek, December 14, 1959: "Balance-of-payments deficit will be reduced, but not eliminated."

Cleveland Trust Co.; Business Bulletin, December 16, 1959: "Net exports of goods and services will be $0.0 billion compared with a minus $0.7 billion in 1959."

Gerhard Colm, chief economist, National Planning Association; Journal of Commerce, December 21, 1959: "Increase in net exports due to improved conditions in foreign industrial markets: $1.5 billion."

Business Week, December 26, 1959: "Net exports should add $1 billion or more to GNP during 1960."

Gerald LeVino, president, Guiterman Co., Inc.; Journal of Commerce, December 29, 1959: "Increase in commercial exports should be between 6 to 8 percent."

Department of Commerce, Survey of Industries; Journal of Commerce, December 29, 1959: "Picture not too clear. Imports will decline and exports will rise."

Donald F. Heatherington, National Foreign Trade Council; Journal of Commerce, December 29, 1959: "Exports will rise by $2.3 billion from 1959 total of $16.2 billion. Imports will rise about $0.5 billion to $15.7 billion. Balance-of-payments deficit will shrink from $3.6 billion in 1959 to $2.8 billion."

Paul McCracken, professor, University of Michigan; Journal of Commerce, December 29, 1959: "Some improvement in the export picture."

Government officials; Journal of Commerce, December 31, 1959: "An export increase of slightly over $2 billion to ease balance of payments. Exports should reach $18.5 billion and imports total about $16 billion."

U.S. News & World Report, January 4, 1960: "Imports up, but exports up more."

INTEREST RATES

James J. O'Leary, director, economic research, Life Insurance Association of America; Business Week, November 28, 1959: "Demand for funds will compel Federal Reserve to keep a tight rein on credit, thus keeping interest rates firm."

House & Home, November 1959: "Don't expect easier money to be reflected in lower interest rates. If money costs slacken at all, they will slacken only slightly and temporarily. Like it or not, we are in for a period of relatively high interest rates."

Survey of Manufacturers; Wall Street Journal, December 7, 1959: "Most think interest rates may rise."

Ragnar Naess, Naess & Thomas; NICB Business Outlook, 1960, December 3, 1959: "May have low in the long-term bond market for some time during first part of the year, with some recovery during the rest of the year."

Malcolm P. McNair, professor, Harvard University; NICB Business Outlook, 1960, December 3, 1959: "Stay fairly high for most of 1960. Some easing toward the end of 1960."

O. Glenn Saxon, professor, Yale University; NICB Business Outlook, 1960, December 3, 1959: "Remain high, with a rise in the longer term rates."

Roy L. Reierson, vice president, Bankers Trust Co.; NICB Business Outlook, 1960, December 3, 1959: "Higher interest rates due to continued high credit demands, a tight banking situation, a reduced buying interest in Government securities on the part of some nonbank investors, and continued credit restraint. Greater part of rise behind us."

Homer J. Livington, president, First National Bank of Chicago; Outlook for Business, First National Bank of Chicago, December 8, 1959: "The demand for credit will tend to exceed the supply and flow of savings, and a reasonably strong demand for bank loans in the first half of the 1960 is probable. In these circumstances, the FRS is likely to continue its present restrictive credit policy. As a consequence, credit in the first 6 months will continue tight and interest rates firm, with any change more likely to be upward than downward."

Newsweek, December 14, 1959: "Money will stay tight. Interest rates for top borrowers may inch up a bit more."

Industry Trends in 1960; the Fortnightly Commentary, December 14, 1959: "Average even higher than in 1959."

"Bank Bond Comment" published by Wayne Hummer & Co.; American Banker, December 16, 1959: "Historic financial events may occur in 1960. Short-term rates should continue to spiral upward and may well attain truly spectacular levels. Yields of long-term Treasury issues may hit 6 percent."

Thomas Gies, professor. University of Michigan; American Banker, December 16, 1959: "Short-term interest rates will be higher."

Robert W. Storer, vice president, Manufacturers National Bank of Detroit; American Banker, December 16, 1959: "Banks should be prepared for a further increase in the prime loan rate as well as an increase in the discount rate."

The Cleveland Trust; Business Bulletin, December 16, 1959: "Sufficient credit will be available to support a higher level of business in 1960. Interest rates will probably advance somewhat, but for 1960 as a whole they are likely to be fairly stable in contrast with the pronounced rise in 1959."

Business Week, December 19, 1959: "All borrowers will be faced with even higher interest rates than at present. An increase in the prime lending rate—now 5 percent—is considered likely before mid-1960."

Gabriel Hauge, finance committee chairman, Manufacturers Trust Co.; Wall Street Journal, December 22, 1959: "Rates have not yet hit the top."

Paul McCracken, professor, University of Michigan; Wall Street Journal, December 29, 1959: "Continued tightness of money will increase interest rates over present levels, but not enough to seriously jeopardize the economy."

Roy L. Reierson, Bankers Trust Co.; Herald Tribune, December 29, 1959 "Little hope of bond yield easing in the months ahead because credit demands will be larger next year, but savings are not likely to increase."

Norris O. Johnson, vice president, First National City Bank; Herald Tribune, December 29, 1959: "Short-term paper interest rates to increase."

Beryl W. Sprinkel, Harris Trust & Savings Bank of Chicago; Herald Tribune, December 29, 1959: "Further increases in yields on both short- and long-term Government securities are probable."

U.S. News & World Report, January 4, 1960: "Borrowing to become even more costly and difficult."

(Whereupon, at 4:15 p. m., the hearing was adjourned, to reconvene at 10 a.m., Tuesday morning, February 2, 1960.)

JANUARY 1960 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, FEBRUARY 2, 1960

U.S. CONGRESS,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to adjournment at 10 a.m., in the Old Supreme Court Chamber, the Capitol, Hon. Paul H. Douglas (chairman of the committee) presiding.

Present: Senator Douglas; Representatives Bolling, Coffin, Reuss, Curtis, and Kilburn.

The CHAIRMAN. Did you have a statement you wanted to make, Dr. Saulnier, or did you think that the report should be treated as your statement?

STATEMENTS OF RAYMOND J. SAULNIER, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS, AND KARL BRANDT AND HENRY WALLICH, MEMBERS

Mr. SAULNIER. I have no statement to make, Mr. Chairman. I do want to say, however, that I am delighted to be here again. This is my fourth appearance before this committee.

The CHAIRMAN. Do you wish to begin the questioning, Mr. Reuss?

Representative CURTIS. Mr. Chairman, I think we are clear on the procedure, are we not, that the statement will be taken, and then Mr. Saulnier will go over it, and as much as can be released will be released? That is my understanding. I am a little uncertain, but I thought we might clear it up.

Mr. SAULNIER. If I might be permitted, Mr. Chairman, to make one or two comments on procedural matters. I have with me my two colleagues on the Council, Dr. Karl Brandt and Dr. Henry Wallich.

And I am especially grateful, Mr. Chairman, that this hearing, as it has been in the past, is being conducted in executive session, and that the rules under which we operate will permit the Council, following this free discussion of the President's Economic Report, to make such adjustments in the written record as seem clearly appropriate.

I should say, Mr. Chairman, that in the past only very minor changes have been made, and I certainly hope that that will be again the case this year.

The CHAIRMAN. I addressed a letter to Dr. Saulnier of the 12th of January, which stated:

> The usual arrangements will prevail, with a stenographic record being taken, the witnesses having the privilege of editing their remarks in any sensitive areas. The edited record will then be printed at the time the hearings are closed.

Mr. SAULNIER. That is quite agreeable to us, Mr. Chairman. We appreciate that courtesy.

The CHAIRMAN. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman.

At the outset, in a nonpolitical way, I would like to record my difficulties with, and my objection to, the closed proceedings here. I appreciate, Mr. Chairman and Dr. Brandt and Dr. Wallich, what you are up against. However, I think it would be better to have the doors open, have the press here, and have the chairman and yourself right at the start of the hearing indicate that we are dealing with a difficult subject matter here. It is quite possible for a witness with the best will in the world, to make an off-the-cuff answer which he might want to correct, and amend at his leisure, and of course that permission should be given.

I really think that this would be more useful than this secret hearing; however, I am perfectly willing to go along.

Representative CURTIS. Will the gentleman yield?

The difficulty is not that, if I may so say. The difficulty we have been in before, just so that the record will show it, is the relation the Council is in to the President, as confidential advisers. That is where the difficulty arises. And it occurred before this administration. There is an area for disagreement, but I think the gentleman should direct his attention to that area, not this business of being able to revise your remarks on technical subjects. The area of which I speak is the violation that might exist of the relation of confidential adviser to the President.

Representative REUSS. As a lawyer, I have always recognized the confidentiality of the priest-penitent relationship, but I really think that the economic advisers are of a little different order, and that the public interest here suggests different treatment.

Mr. Saulnier, does the Economic Report of the President this year contain any observations or recommendations on the increase in the money supply for the year to come, which is envisaged as a proper one?

Mr. SAULNIER. The Economic Report, Congressman Reuss, contains the statistical tables that have always been in the report on money supply. It contains also a discussion, albeit a brief one, of developments in the money supply during the year 1959, and compares them with earlier years; and, as I am sure you have observed, the report contains a discussion of Federal Reserve policy during 1959 and the role that it played in helping to promote the expansion of our economy during that year.

Finally we have indicated in the final chapter the importance of monetary policy to the extension of the expansion in 1960 and beyond.

Representative REUSS. You do not, either in the final chapter or anywhere else, so far as I have been able to find, set forth what you regard as a proper rate of increase or decrease in the money supply for the upcoming 1960 year, do you?

Mr. SAULNIER. Only in very general terms, Mr. Reuss; those general terms being that the expansion of the money supply, construing the money supply in this instance as demand deposits plus currency, should increase in any given period at a rate which is appropriate in terms of the growth needs of the economy; and, furthermore, and this is a very important point, with account taken of the growth of

other forms of liquid assets, which in our economy increasingly perform a function similar to that of the conventional cash balance.

Representative REUSS. But outside of this general principle that there should be an increase in the money supply, as defined, appropriate for the growth needs of the economy, you do not say either what the growth needs of the economy are in 1960, or what an appropriate increase in the money supply sufficient to lubricate those needs would be, do you?

Mr. SAULNIER. We have not stated, sir, what we thought the increase in the money supply ought to be over the calendar year 1960.

Representative CURTIS. I did not hear that.

Mr. SAULNIER. We have not stated that. Indeed, I would find it very difficult to do so.

Representative REUSS. Do you, in your report, state anything on whether you are in favor of or oppose the bills-only policy of the Federal Reserve?

Mr. SAULNIER. We have not stated in the report a position on the bills-only policy. We have, perhaps by implication, indicated no opposition to that policy as, at this time, an effective way of operating the open market operations of the Federal Reserve System.

Representative REUSS. How have you implied no opposition to the bills-only policy in the report?

Mr. SAULNIER. Only in the sense, sir, that the report expresses in general a satisfaction with Federal Reserve policy as it has developed in the year and, I should say, in the recent past.

Representative REUSS. Do you conceive it within the purview of the report to comment on Federal Reserve matters just as freely as you comment on fiscal matters, price matters, production matters?

Mr. SAULNIER. Congressman Reuss, this raises an important question. It is, however, at the moment an academic question, though I label it as such not to disparage it.

Being reasonably satisfied with the conduct of Federal Reserve operations, there is no need for us to raise questions about the bills-only policy. But suppose that the Executive had some reservations about it. Suppose that the President had some reservations about that. Then there would be a question whether he should air those reservations in his Economic Report to the Congress.

Now, remembering that the Federal Reserve System is an independent agency within the executive branch, my thought as to how such a question should be handled is this. If we thought that it would be really essential to the growth and stability of our economy that the Federal Reserve System depart from its bills-only policy and move into the intermediate and longer-term range of securities for the conduct of its open market operations, my first step would be to discuss this with the Reserve authorities, as I discuss all such questions, quite freely and, so to speak, within the executive family.

Representative REUSS. And suppose you had discussed this within the executive family to no avail. And bear in mind that the Federal Reserve seems to pop in and out of the executive family in a very puckish sort of way. Are they in or out of it for this purpose?

Mr. SAULNIER. My conception of their position is that they are independent within the executive branch.

Representative REUSS. At any rate, suppose that whether they are in or out, discussions for more than a year, let us say, have proved unavailing, but the Council of Economic Advisers and the President still felt that in a given area the Federal Reserve's action was inimical to the best interests of maximum production, employment, and purchasing power?

Mr. SAULNIER. Yes.

Representative REUSS. Under such circumstances, should mention of this be made by the President and his Council of Economic Advisers in the annual report, or should it be glossed over in silence?

Mr. SAULNIER. First, sir, you are raising a hypothetical issue. It is not an issue at this time.

Representative REUSS. But it is an important issue.

Mr. SAULNIER. It is a hypothetical issue; but let us suppose that such an issue did arise. Let us suppose that it had been discussed fully with the Federal Reserve System and we had simply agreed to disagree on an important matter of monetary policy. It would, in those circumstances, it seems to me, be appropriate for the President to take this matter to the Congress, with the thought of its full discussion in the Congress.

Representative REUSS. I am glad to hear you say that.

Mr. SAULNIER. Mind you, I do not want to imply by that any feeling of dissatisfaction with the bills-only policy today, or in any circumstance that I can imagine arising in the future.

Representative REUSS. I think your testimony on that covers the academic point, on which you have made yourself quite clear. I take it that it is your testimony that the President and his Council of Economic Advisers are fully satisfied with the actions and attitudes of the Federal Reserve Board at the present time; that if you were not, you would say so; and that we may therefore, in your phrase, "imply" that you are satisfied.

Mr. SAULNIER. You may imply that, sir. Let me correct my language. You may infer that.

Representative REUSS. The report, unless I have missed it, is likewise silent on the question whether the Federal Reserve should, in situations where it wishes to expand the money supply, do so by the method of lowering reserve requirements as opposed to the method of purchasing U.S. securities. I take it your silence there, too, indicates an agreement with the present policy of the Federal Reserve.

Mr. SAULNIER. The report is silent on that point. And, it not being a policy issue at this time, there is no real reason for its being discussed in the President's Economic Report.

That is the reason for its not being there. I would not want to suggest that you may infer acceptance on our part of a practice just because it is not discussed in the Economic Report. That would be obviously unfair and I know you do not want to infer that.

Just independently, my own feeling on this is that if this were an issue, I would like to see our Reserve System with as many tools as possible at its disposal. There are times when it is appropriate to employ open market operations as a means of affecting reserves. There are other times when it is better to do it by a change in reserve requirements. I am an eclectic in these things.

Representative REUSS. And if the open market method results in substantial savings to the taxpayers, and has the same monetary con-

sequences as the reserve requirement lowering method, then you would not object to the use of the open market method, or to the giving of the taxpayers the resulting break which they get from that method, would you?

Mr. SAULNIER. My attitude toward that, Congressman Reuss, would be simply this: That when it comes to a practical question of affecting reserves in a given situation, one should consider all the methods that are available, and there are two here. A more liberal discounting policy is a third. One should compare the pros and cons for each one of these methods from the point of view of the public interest and select the one which, on balance, is most desirable. And among those pros and cons, obviously is the question of what a particular method might cost the taxpayer. And what it might cost more generally to the economy would also be a pertinent consideration.

Representative REUSS. I like to hear you say that.

I also fail to find in the report any recommendation that Congress enact standby controls over consumer credit. I take it that is an indication that you are opposed to the enactment of such standby controls.

Mr. SAULNIER. In looking at the economic situation today, and at the economic situation as it may develop in the year 1960, we have seen no need for changing the position we took in 1958 when we decided not to request authority—standby authority—for consumer credit controls.

The absence of this recommendation in the Economic Report is evidence of our belief that we do not regard such controls as needed at this time.

Representative REUSS. I see that my time is up.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Kilburn.

Representative KILBURN. Not now.

The CHAIRMAN. Congressman Bolling?

Representative BOLLING. Mr. Chairman, I do not like to repeat ancient history, but the record of executive sessions will show that I was the one who most violently disapproved of the decision to have the Council heard in executive session in these terms. I have just reread the Employment Act, and I will admit offhand that the point made by my friend from Missouri, Mr. Curtis, is an arguable point. You could argue it either way. My objection has always been that by making this decision we have in effect deprived the American people of any comment in public by any excutive source which deals with the whole of the economy. The President does not appear before the Congress; and for good and sufficient reasons; and when the Council do not appear in public session, the people of this country, and the Congress, are in effect deprived of the opportunity to question the generalists in the field of economy.

Representative CURTIS. To get away from the academic and the hypothetical that my good friend from Wisconsin is indulging in, as I analyze the report, we show pretty good price stability over the immediate past. And would you say that we can look forward to that for the immediate future; at least the period contemplated in the report?

Mr. SAULNIER. We had a high degree of price stability in the first half or so of the year 1959. However, the consumer price level has started to edge up a bit in the second half of the year.

Now, we have described that movement in the report. We have tried to do that in some detail, to show the components of the Consumer Price Index that have been moving up. We have also commented on the movement of wholesale prices.

On the whole, I think it is a pretty fair record for an economy such as ours, though I should like to improve on it. I should like to come here and report that the price level was entirely stable.

Representative CURTIS. In other words, you do feel that there are forces at play that could produce price instability if unchecked?

Mr. SAULNIER. Oh, yes; indeed. There are powerful forces in our economy that can produce that, and they are at work all the time. And the fact that you had only a very small increase in the Consumer Price Index during the year is no indication that the forces at work were of only moderate intensity during the year. They were very powerful. They were, fortunately, held in check by our general economic policies.

Representative CURTIS. Now, touching the next goal that people like to talk about, of economic growth, your report contemplates roughly a growth to about $510 billion GNP in 1960. I think the panel yesterday was pretty much in accord that that was a realistic estimate. In fact, some of them went even higher, to around $515 billion. Is that about right?

Mr. SAULNIER. The financial agencies of the Government—the Budget Bureau and the Treasury—have correctly stated that an assumed gross national product for the calendar year 1960 of $510 billion underlies the revenue estimates of the fiscal 1961 budget. But we all understand, of course, that it is very difficult in our economy to make estimates of this kind. No one can certainly be sure that any one particular number is "the" number. Rather, we can think in terms only of a range of possibilities. On the other hand, in drawing up a budget one has to use a particular number and this seemed to be a reasonable estimate within the range of the probable actual outcomes.

Representative CURTIS. If that were right, just checking, that would give us a 6 percent increase in growth in 1959 to 1960. I just checked that, and apparently it is so. And it would also put a range over the past few years back to this 3 percent or close to 3 percent figure that everyone attached importance to, or many people attach importance to. I am simply trying to get out in the open how well we are doing in regard to the first two goals. One is price stability, and the other is economic growth.

Now, one of the questions is whether or not we are going to have the necessary capital to support the anticipated growth for this year; and the panel yesterday by and large seemed to think that the capital would be available. I wonder if you would comment on that aspect, the savings aspect, and whether or not there seems to be, in a tight money situation, sufficient capital available to attain these levels.

Mr. SAULNIER. A rate of economic growth of 6 percent in a single year, to take the figure you mentioned, would not necessarily be obstructed or prevented from occurring by a lack of capital. Indeed, in many single years our economy has grown at a faster rate than this.

Your own recent report put the growth from 1958 to 1959 at 7 percent. In my own calculations, I put it fractionally lower than 7 percent—6.7. And the growth between 1959 and 1960—if we are to achieve, as I expect we shall, a $510 billion GNP for the year—would imply a growth of something less than 6 percent.

Representative CURTIS. I just checked with one of our staff men, and I think that is probably right. It does not matter. We can correct it for the record.

Mr. SAULNIER. I get a figure just fractionally below 5 percent.

But that is, of course, a very high rate of growth for our economy.

Representative CURTIS. What I wanted to get to was a specific. What part does the $4.2 billion projected surplus in the budget play in this picture of money needed, capital needed, for the growth in the private sector, and this question of tight money and high interest rates?

Mr. SAULNIER. It will be a source of savings, so to speak, for our economy in the fiscal year 1961. It will return funds to the capital markets.

Representative CURTIS. Do you regard it as important or significant?

Mr. SAULNIER. I regard it as a most important factor in facilitating the expansion of our private economy and the activities of our State and local governments in that year.

Representative CURTIS. Do you think it would have an important effect on our interest rates?

Mr. SAULNIER. Yes, indeed.

Representative CURTIS. To make them not as high?

Mr. SAULNIER. It will tend to ease pressures in the capital markets. To that extent, it will make it easier for the private economy and State and local governments to get the funds which they need for the expansion of their projects.

Representative CURTIS. Now my time, I think, is about running out, and I want to mention the third factor and then come back, because I do want to ask some questions on that. That is in regard to unemployment.

Mr. SAULNIER. Yes.

Representative CURTIS. This seems to be the area where, as far as these three economic goals that we have been discussing are concerned, there is a troublesome thing that needs looking into; and I would like to examine into that at a later time.

The CHAIRMAN. Congressman Coffin?

Representative COFFIN. Thank, you, Mr. Chairman.

Mr. Saulnier, I would call your attention to page 8 of the President's Economic Report, where labor-management negotiations are discussed. It is said there that there is a need not only for expression in the form of public opinion, but that—

We must go further in establishing a broad public understanding of the relationships of productivity and rewards to costs and prices.

What do you mean? How far do you go in urging that this understanding be created? Do you contemplate voluntary hearings in crucial industries at a time of wage-price negotiations or proposed increases? Do you contemplate compulsory hearings? Do you con-

template something else? Or just general attempts in an uncoordinated way to convey information in this difficult field?

Mr. SAULNIER. Mr. Coffin, I would not read the President's Economic Report as suggesting a need for hearings in connection with particular labor disputes. What we need is to develop a better public understanding of the relationships between wage and other cost increases and productivity and unit cost of production and price.

This can be done in a number of ways. The hearings that your own committee held over the last summer have, it seems to me, helped a great deal toward this end, and I should like to commend the committee for this.

There has also been a good deal of floor discussion in the Congress on these matters. These have helped, I believe.

Representative COFFIN. I just wanted to interject that we cannot be sure of holding a study such as we have held this year every year; that is not to be a recurring phenomenon.

Mr. SAULNIER. No, but it has a lasting effect, sir. These things are cumulative. They tend to build up over time. And I would say, Mr. Coffin, that public understanding of the relationship between costs and particularly labor costs and productivity and prices is very much better today than it was, let us say, a year or 2 years or 3 years ago. I think we are a good bit better informed about this relationship and that this is true broadly through the country.

Representative COFFIN. Mr. Saulnier, I hate to disagree with you. I think it is talked about more than it has ever been, but I must confess that when I read the press or hear some of our colleagues on both sides of the aisle, I am not so clear that we are becoming very sophisticated about the relationship between productivity and wages.

Mr. SAULNIER. I am surprised to hear you say that, sir. It conflicts head on with my own appraisal of what is happening.

Representative COFFIN. Are you being realistic in hoping that we will get enough of an understanding by enough people to have a solid and rational impact in big price and wage moves?

Mr. SAULNIER. Well, I do not look for miracles in this. But I look for improvement. And I must admit, Mr. Coffin, that after 25 years as a university teacher, I have been hardened to accepting the fact that probably the improvement will not be very rapid. But it is there. It is going forward. In contrast to some few years ago, when people might have said: "I don't know that it makes very much difference how much of a wage increase is granted in an industry. The important thing, perhaps, is just to expand the purchasing power of our economy." Nowadays people say: "Just a minute. What is going to be the effect of this wage increase on costs in this industry?" And they will tell you that that will depend on how fast productivity is going ahead in that industry. And they can point to the relationships between increases in costs and increases in prices generally. And they can say some quite significant and correct things about the relationship between increases in prices and our capacity to sell in foreign markets.

Representative COFFIN. You say they say some correct things?

Mr. SAULNIER. Yes, indeed.

Representative COFFIN. And they say a great many incorrect things, too.

Mr. SAULNIER. That is true too; and that is why we are trying to improve public understanding of these things.

Representative COFFIN. But you have no specific suggestion of what the Government can do to increase this popular understanding.

Mr. SAULNIER. One of the things we have done, Mr. Coffin, is to direct public attention to this problem in the President's Economic Report.

My colleague, Dr. Wallich, would like to add a word at this point.

Mr. WALLICH. I would just like to add to what Dr. Saulnier said, that we have had some experience with creating a climate of public opinion as regards action against recession and depression. It has taken a long time to create that climate of opinion, but we now do know that we can take action against that kind of situation. And it is in this broad sense—regarding the problems of inflation and the mechanics of inflation—that we are here trying to generate a public consciousness and a better understanding.

Representative COFFIN. To change the subject, Mr. Saulnier, you answered Mr. Reuss' question about standby credit control by saying that last year and again this year this is not a real problem. We are not now talking about general credit controls but about standby selective credit controls. If you foresee that there might come a time when buying power would be so great and supply would be so limited that, even with our present very elaborate apparatus of credit, there might be a problem, what reason is there not to explore the best possible approach in the field of standby controls, so that we can have our weapons available if we need them and not have to fabricate the weapon in the heat of a crisis?

Mr. SAULNIER. That is a very fair question, Mr. Coffin. Let me say, first of all, that there is hardly any variety of credit control, outside of such broad measures of control as open market operations, with which we have had more experience than with consumer credit control.

I say that, sir, only to suggest that if an occasion were to arise when a need for consumer credit control was clearly evident, there would be no difficulty in framing very quickly the appropriate regulations.

Second, I do not see at the moment any need for the use of such controls. If we had them on the books now, I would not be here this morning suggesting that we ought to use them to tighten credit for purchases of automobiles. This is not what I read from the statistics on the automobile industry.

And if you were to ask me: "Do you see a future need for such controls looking as far ahead as you can at this time?"—I would tell you that I do not.

Under these circumstances I see no need for proposing that the Congress legislate standby credit controls.

Now, if I may make one addition to that, sir: You may recall that in the Economic Report of January 1959, we said that if standby controls had been available, 1956 might have been a good year to use them.

Let me take that back, sir. This was January 1956, and we said that 1955 might have been a good year to use them.

Remember the circumstances. There had been a high rate of expansion of the volume of consumer credit, and there had also been a very rapid and substantial liberalization in the terms on which the credit was being extended. But to all intents and purposes that water is over the dam. I see no evidence of a general liberalization of consumer credit terms at the present time.

But if I saw that happening, and I thought it was developing a demand for automobiles so great that we were in effect selling next year's automobiles this year, and thus borrowing trouble for next year, I might very well favor restrictive action.

Representative COFFIN. Do I understand you to say that in 1955 that would have been helpful?

Mr. SAULNIER. That was the considered judgment expressed in the President's Economic Report for January 1956.

Representative COFFIN. Were you on the Council then?

Mr. SAULNIER. I was a member of the Council at that time, sir.

Representative COFFIN. Now, in 1955, did you foresee this?

Mr. SAULNIER. My recollection is that it was not until April or May that it was clear that we had quite a surge of buying on hand.

Representative COFFIN. My point is simply this. In April or May of 1955 that was the best data that you had, and I hope today we have better data than we had then.

Mr. SAULNIER. We do, indeed; and partly as a result of that experience.

Representative COFFIN. Now if you came to Congress in April or May of that year and asked for standby credit controls, and Congress then was anything like it is now, it would have been difficult to get legislation through both Houses and signed by the President before late fall or early winter.

Mr SAULNIER. I think it is correct to say that the Congress would not have been receptive to it.

Representative COFFIN. So why not have standby controls, so that when a situation like the spring of 1955 comes along——

Mr. SAULNIER. To correct 1955? But 1955 is gone.

Representative COFFIN. But something like 1955 could be created in the future.

Mr. SAULNIER. Well, now, just a moment. If what you are saying, sir, is that you expect in some future year to witness a liberalization of the terms on which automobiles are sold on the installment plan comparable to what occurred in 1955, I would not be able to agree. I think we are about at the end of the road in this matter.

Representative COFFIN. I am not talking just about automobiles. I am talking about consumer credit in any field where excessive buying in a given period might create a problem which we could otherwise avoid. I am not saying 1955 will ever repeat itself precisely. I am just trying to draw a moral that it would have been good to have had some weapon in the arsenal which could have been used in June or July of 1955.

Does this not hold a moral for us in the future? Maybe not for this particular phenomenon, but for something of the same general nature?

Mr. SAULNIER. But, Mr. Coffin, the problem in 1955 was in automobiles. It was not a general consumer credit problem. It was an automobile problem. And what I have said, sir, is that I do not expect to see any further general liberalization of terms in that area such as occurred in 1955. I think we are talking about a problem that is past.

The CHAIRMAN. Mr. Kilburn?

Representative KILBURN. As to this one question, I do not want to take too much time, but I have been shown the rules of our com-

mittee, and it says it shall be the function of the joint committee to make "findings and recommendations with respect to each of the main recommendations made by the President in the Economic Report." I am wondering, sir, what you consider the main recommendation.

Mr. SAULNIER. I will be very glad to respond to that, sir. We have, as you know, included in the Economic Report a chapter setting forth an economic program for 1960. This is in keeping with the express requirement of the Employment Act. I can summarize very briefly the major items of that program.

First, the President has put forward a budget which, as you know, contemplates the achievement of a surplus of something over $4 billion in the fiscal year 1961.

We believe that the enactment of the appropriations requested in that budget, and the extension of a number of taxes which are specifically requested here, would provide the basis for a sound extension of economic expansion in the year ahead. I have already indicated how helpful such a surplus, used to retire the Federal debt, would be in promoting the private economy and in promoting the activities of State and local governments.

Second, we have proposed that the present ceiling on the interest rate that can be paid on the longer term Federal obligations be removed. We believe that this, too, enacted promptly, would be a powerful aid to growth on a sound, sustainable basis.

We have, in addition, put forward a number of specific proposals in the field of competition which I was glad to see the Joint Economic Committee support in its own report to the Congress.

We have again put forward a suggestion in the area of small business. And the administration, as you know, is making some suggestions for changes in the Small Business Investment Act.

Legislative proposals are also made in the field of housing, in agriculture, in personal security, and in connection with natural resource development.

And we have recommended again the enactment of legislation that would assist areas that experience greater than average unemployment. The administration has a bill before the Congress which it regards as a constructive approach to this problem, and we are hopeful for its passage.

Representative KILBURN. I did not want to go into it too much, because we have the summary. But do I understand, then, that the two main things are the budget and the ceiling on long-term bonds?

Mr. SAULNIER. They are two very important things. They are key things. And, of course, when one says "the budget," one means not just the overall balance but also the appropriations which it proposes in areas that are designed to promote the growth of our economy.

Representative KILBURN. Thank you very much.

The CHAIRMAN. When the committee agreed to the original demands of Dr. Burns that the hearings should not be public and that he should be permitted to alter any testimony that he wished, I think I voted in the negative, but a majority of the committee voted for it; and since then, as chairman, I have tried to carry out the decision of the committee and to cooperate to the fullest degree possible. I have

come to the conclusion, as the years have passed, that with the composition of the Council as it is, and with the rules of the committee, these discussions are fruitless and I regard them largely as a waste of our time, and I suspect also a waste of the time of the members of the Council. And so, while I extended the invitation this year, I feel very much as Mr. Bolling feels, and therefore I shall ask no questions; although I believe that the other members of the committee should, of course, be given the opportunity to ask such questions as they wish.

Congressman Curtis?

Representative CURTIS. I wanted to discuss a little bit the third goal that is set out in the Employment Act, the question of unemployment. I have been disturbed, as I know many people have, and I think the Council, too, is disturbed with this seemingly high plateau that the unemployment figure seems to reach, or higher plateau, after each of the recent recessions.

I have tried to figure out what the economic figures might be that lie behind that. There has been so much of what I regard as just political garbage in the discussion about it that it has not been very meaningful.

I have made a few notes here, that I would just like to go over.

The first point, it seems to me, and I have posed it before many of our panels, is that if we have technological growth, the frictional employment is almost inevitably going to increase, and most of the economists to whom I have posed that question have agreed. And yet I do not think anyone has really studied it. Maybe it cannot be exactly studied. But it just strikes me that that is so; and if it is so, then those in particular who seek to have more rapid growth must recognize that the forces that apply in this area are going to become greater, and our problems of coping with frictional unemployment—and I think there are ways of coping with it—will also become greater.

I might stop at that point just to ask for your observation on that.

Mr. SAULNIER. Well, I would agree, Mr. Curtis, that as the rate of technical advance steps up in our economy, the incidence of what we call frictional unemployment would be expected to increase also; and it may well be that something of that kind has been occurring in recent years.

But let me make this additional observation, sir. I would hesitate to draw any conclusions about how our economy is going to operate over the long term on the experience of, say, the last 10 years.

Representative CURTIS. In other words, you do not think that this trend in the fluctuations in our economy—going through periods of boom, then down into recession and back into boom of coming out each time with a little higher incidence of unemployment will continue?

Mr. SAULNIER. Let us look at what the record tells us on that.

Representative CURTIS. All right.

Mr. SAULNIER. The number of persons unemployed got down to a bit under 2 million just prior to the 1953–54 recession. Then, at the outset of the 1957–58 recession, it had increased by approximately a million. And at the present time it is just under 4 million.

I would not infer from this that the setup from 2 to 3 to 4 million unemployed will necessarily be extended further. I do not regard this 4 million figure as the low point that we will reach in 1960 or 1961.

On the contrary, I would expect unemployment to be reduced substantially in 1960.

Representative CURTIS. Do you think in 1960 unemployment will go below the figure before the 1957-58 recession?

Mr. SAULNIER. I think there is a very good chance that it will.

Representative CURTIS. Then if it does, that in itself would relieve my concern about this.

Mr. SAULNIER. This would call for some new theories.

Representative CURTIS. Yes, it certainly would.

Certainly, though, in my judgment, we ought to get into the composition of this unemployment thing one thing that I have noted in the figures: that the unemployment in the recent recession and in the previous ones has been concentrated very heavily in the unskilled and semiskilled areas.

Mr. SAULNIER. There is no question about that, Mr. Curtis. You will observe in the reports of the Department of Labor on conditions in various labor markets that there are very great differences in the demands for different types of workers. I do not find the exact reference, here, but my recollection is that in practically every major labor market area in this country shortages have been reported of skilled, professional-type workers. This is a very interesting and significant fact.

Representative CURTIS. Yes. I have seen it in a subjective way, not on statistics, but just in the advertisments in the New York Times for engineers and those skills.

Have there been any studies other than that on this question of that which I have termed "overemployment," which is not a good term? Can you supply a better term? Shortages of skills refers to a specific; but we actually have areas where there is a complex of shortage of needed labor.

Mr. SAULNIER. The Department of Labor is continuously making studies of these matters. The particular reference to which I referred is in a Department of Labor paper of January 28, in which it is reported that:

> Widespread shortages of skilled and technical workers still persist, chiefly skilled metal workers and engineers.

Representative CURTIS. I have noticed the shift, too, in the manufacturing sector from blue collar workers to white collar.

Mr. SAULNIER. This is also an important trend in our economy, and a gratifying one.

Representative CURTIS. Senator Douglas has oftentimes pointed out, taking the other side of the coin here, that we are not measuring in our unemployment figures the factor of underemployment or part-time employment. I wonder if that, too, ought not to be considered in our trying to get a real picture of what this unemployment situation might be.

Mr. SAULNIER. We have probably more extensive statistics on these matters than any country in the world.

Take for example this monthly report, "The Labor Force." I have before me the report for December 1959. It is compiled by the Department of Labor.

51708—60——11

You leaf through this, and you will get a very considerable amount of information on the characteristics of the unemployed; and tables on the unemployment status of our population by all kinds of classifications.

Representative CURTIS. Does that hit at the point that Senator Douglas has made? Does it attempt to measure in any way the incidence of under employment or those not fully employed?

Mr. SAULNIER. Yes, indeed. It gives distributions of those people at work, according to the number of hours they worked.

Representative CURTIS. The other side of the coin, there, too, is the moonlighting that might go on; that is, holding of two jobs by the same person. And in questioning yesterday, I think Mr. Paradiso or maybe Mr. Henle pointed out that our employment figures do not reflect the duplication. In other words, we rely on them; and yet some other figures we do tend to rely on, those compilations of the reports from industry on their work lists, might reflect this duplication.

Mr. SAULNIER. That is correct, sir. That is one of the difficulties we have in comparing the so-called labor force statistics on employment with the payroll statistics on employment.

In the labor force statistics, which are compiled by Census, people are counted on a household basis. An employed person is counted as employed without respect to the number of jobs he may hold. The fact that he may have more than one job is not pertinent to his or her identification as an employed person. There is no double counting in this case.

On the other hand, when you go to payrolls, as the Bureau of Labor Statistics does, and count the number of people on employers' payrolls, a given person might be on two payrolls and there is a chance that double counting will occur.

Representative CURTIS. I have often thought, too, of the really, it seems to me, vast improvements in our labor statistics over recent years. It may be that what I have expressed concern about is partially due to better statistics.

Mr. SAULNIER. That is a possibility. I expect there are a number of ills in our society that look large nowadays in part because we count them better than we used to.

Representative CURTIS. Now I will just go through briefly these other things, simply to get this picture complete, as I see it.

Even in the unskilled area, we find what seems to be a labor shortage, a shortage of labor in the farm labor field; and yet, on the farm is where we seem to have a lot of frictional unemployment. I refer, of course, to the fact that we still import great numbers of Mexican laborers, simply because our people who were unemployed just do not want to do that kind of work. And the same, I think, is true in household service and many of the service fields.

When we get to the question of frictional unemployment, I think we certainly can see in the rural areas where the older farm in particular has been displaced. We see it in areas where there is competition from imports, which I regard as a type of technological advancement, although it is technological advancement abroad.

I have wondered about this question, the effect of the maturing of our unemployment insurance programs on this factor of unemployment, because there we automatically will measure the number unemployed; and yet in our studies on ways and means for this legislation,

which we have jurisdiction over, we find work patterns develop where people actually go on unemployment insurance with great regularity and then go to work in their seasonal jobs somewhere else.

I have raised the question—knowing the high incidence of unemployment among the younger people, those new entrants, particularly the males rather than the females—of what the impact of the effect of the draft law might be. And then finally the work habits of our older people, who sometimes get put into the unemployment figures; and yet this unusual situation, which no society has ever had before, of people living 10 and 15 years longer, and being able to work effectively, probably, beyond ages that 20 or 30 years ago were thought of as being normal for retirement.

The only point I make here is that if the reports of the executive department to the Congress in this area are to be meaningful, I think possibly a more thorough study into the peculiarities of unemployment and employment in the present day would be very helpful and would remove a great deal of it, at any rate, from the political arena, because we are dealing with human beings and also a very important phase of our economy.

The CHAIRMAN. Mr. Reuss?

Representative REUSS. Mr. Chairman, do you anticipate eased credit conditions and lower interest rates generally this year?

Mr. SAULNIER. Actually, as you may have observed there has recently been some change in this respect in the long-term capital market. This was not a great surprise to me. I think it was to be expected in the current economic situation.

Representative REUSS. Then you would expect, throughout 1960, a continued ease of credit conditions and continued lower interest rates?

Mr. SAULNIER. Not necessarily a downtrend of interest rates, but I would expect the achievement of a surplus in the Federal budget in the fiscal year 1960 and the prospect of a substantial surplus in fiscal year 1961 to ease pressures in the capital markets and to help keep interest rates lower than they would otherwise be.

But I expect the demands for capital to remain heavy for private investment, both for plant and equipment and to some extent also for inventories.

I expect consumer credit demands to continue heavy, and I would also expect a strong demand for funds to finance State and local investment projects.

All of these things put pressure on the supply of savings. And I would expect that pressure to continue high in the months ahead.

Representative REUSS. Yes. I think you are quite right in envisaging a continued high demand for savings. But is it not a cornerstone of your report that you expect a greater supply of savings available?

Mr. SAULNIER. As income expands; that is correct, sir.

Representative REUSS. Also as a result of the projected $4 billion budget surplus?

Mr. SAULNIER. That is correct.

Representative REUSS. Is that not a very key element in your President's Economic Report?

Mr. SAULNIER. It is, indeed.

Representative REUSS. And you agree with me, I am sure, because that is what you say, that a budget surplus is a good thing for the

reason, among others—and here I am going to quote what you say on page 6—that—

The added savings which it would supply to the economy would help keep interest rates lower than otherwise and facilitate private investment activity and the financing of public projects by State and local governments.

Mr. SAULNIER. That is correct. I would expect it to do that, and in doing so to be very beneficial in helping to achieve the objectives of the Employment Act.

Representative REUSS. Particularly in the provision of more of the things that State and local governments do with borrowed capital, like build schools and highways and sewerage works and waterworks?

Mr. SAULNIER. Absolutely. All of those things—which I hope to see go ahead at a good, brisk rate in 1960 and in 1961.

Representative REUSS. I could not agree with you more in delineating that as a worthy goal.

If that is a worthy goal, which we agree it is, and if that goal can be attained through lower interest rates, and if lower interest rates proceed, as you have indicated—and I agree with you there, too—from a budget surplus, cannot that which is good be made even better by having a sure—more meaningful and larger budget surplus than that which is herewith hopefully projected?

Mr. SAULNIER. It could be. It could be, sir.

Representative REUSS. The Joint Economic Committee, in its study released on January 26, last week, as a result of its year-long study of the economy, set forth on pages 22 to 24 a whole series of recommended methods of increasing the revenues. Without listing them all, and I think there are some seven or eight, they included an attack on the collection at the source of interest and dividend payments, plugging loopholes in the estate tax, and similar recommendations, which would yield, it was projected, several billions of dollars on the revenue side.

Does the failure to include those recommendations, which appeal to the majority of the Joint Economic Committee, in the legislative recommendations which you make in your 1960 Economic Report, indicate that the President and his Council of Economic Advisers are opposed to those specific items?

Mr. SAULNIER. Those specific items? Not necessarily. I believe, as a matter of fact, that the Secretary of the Treasury, who has direct responsibility for these matters, has indicated a readiness to discuss this whole matter of corrective tax legislation with the Ways and Means Committee.

Representative REUSS. Would it not be a good thing for the country if the adminstration, the President, the Secretary of the Treasury, would rather promptly come before the Congress and the Ways and Means Committee with an across-the-board program looking toward the improvement of our tax structure, both from the standpoint of growth and from the standpoint of equity, so that the excellent idea of a budget surplus in prosperous times could become more of a reality? Would not that be getting ahead faster toward our goals if the President and the Secretary would do that?

Mr. SAULNIER. As I say, it is my understanding that the Treasury is working cooperatively with the Ways and Means Committee in its studies of this very matter.

Representative REUSS. Well, study is fine, but would it not be in accord with the leadership role which any administration has to play in our economic affairs, if the administration, with the same degree of specificity that attends their request for an increase in the aviation

fuel tax to 4½ cents, for example, would come in with recommendations on the items included in the Joint Economic Committee's report?

Mr. SAULNIER. That could be, sir. And in the absence of activity on this very matter by the House Ways and Means Committee possibly some such suggestions might be desirable. But I would repeat that it is my understanding that the Treasury is currently working cooperatively with the House Ways and Means Committee on this matter.

Representative REUSS. My point is this: The President in his Economic Report is most specific and insistent on the raising of the 4¼-percent interest ceiling, which would have the effect, of course, of resulting in the issuance of U.S. bonds bearing a rate higher than 4¼ percent if the ceiling were eliminated. If he can be that specific on methods of getting the interest rate up, why can he not be equally specific on methods of getting the interest rate down by the excellent fiscal method, which I am glad to see is grasped by the administration, of seeing that we run a budget surplus?

Mr. SAULNIER. This is essentially a procedural question. As I say, I understand that the Treasury is working cooperatively with the House Ways and Means Committee on its studies of our tax structure.

Representative REUSS. But is it not a very important procedural question?

Mr. SAULNIER. Indeed it is, very important.

Representative REUSS. If the President's Economic Report is supposed to present an across-the-board picture of the economy and set forth in one document those things which, in relation to a particular year, are necessary to obtain the goals of the Employment Act——

Mr. SAULNIER. Which is what the document strives to do.

Representative REUSS. But is it not dificient in its delineation of those reforms in the tax structure which are really necessary if we are going to run a budget surplus of the reality and dimensions necessary to accomplish the worthwhile goals which you set forth on page 6 of the report?

Mr. SAULNIER. I am unable to recall the exact date, Congressman Reuss, but I have a distinct recollection of a letter, a rather lengthy one, prepared by the Under Secretary of the Treasury, on the problems to which you are directing attention, in which very specific questions were put to the Treasury and very specific and very full responses were made to them.

It is my understanding that these matters are still under discussion and study by the House Ways and Means Committee, and that the Treasury is cooperating fully with the House Ways and Means Committee.

I say this is a procedural matter. It is my belief that it is being handled appropriately.

Representative REUSS. Do you not think it would be better, in terms of political economy, if the administration, in its annual Economic Report, adopted a really broad and across-the-board view of its function, if it ceased handing out these important questions to the Ways and Means Committee, if that is what in effect has happened? I would have thought that the purpose of the Economic Report was to present in one document those things which the administration felt needed to be done, whether they are in the field of tax policy, in the field of monetary policy, price policy, wage policy, or whatever; and if we find a hiatus in there, if we find that an important part of

the whole is relegated to discussions and conferences with the House Committee on Ways and Means, do we not lack an important element in the report? And would it not be a good idea in years to come if, let the chips fall where they may, the administration said:

> These are the things in the tax field that we think ought to be done. If the Ways and Means Committee does not wish to go along, that of course is its constitutional prerogative, but here is what we think should be done.

Would that not be a better way to produce an Economic Report?

Mr. SAULNIER. If this were a matter on which the administration had a fundamental difference with the House Ways and Means Committee and a matter of current legislation, it would of course be important to cover it in the Economic Report. But I do not see that that is the situation in the present case.

Representative REUSS. But my difficulty is that I do not know what the Ways and Means Committee has in mind. I do not know what the administration has in mind. So that we have no national tax policy. And I think the logic of the excellent analysis on page 6 of your report is that we ought to have a national tax policy, and that it is essential; that unless we have a national tax policy based upon both growth and equity, we are not going to do much about running budget surpluses, and hence we are going to continue to thwart, by unnecessary high interest rates, the provision by local communities and by States of the schools, the highways, the hospitals, the sewerage and waterworks, that are so necessary to our development.

Mr. SAULNIER. I am sure you have your own means, Mr. Reuss, for informing yourself of what the House Ways and Means Committee is doing. For myself, I will make a particular point of checking my own understanding of the work that the Treasury is doing with that committee.

Representative REUSS. I will not pursue the point further, other than to say that in my opinion the fact that a matter is under study by a relevant committee of Congress does not absolve the administration of the obligation of making up its own mind as to the desirability of particular measures and either recommending that they be adopted or, if it disagrees with them, recommending that they be not adopted. And I think that the Economic Report would be much more valuable in the future if it did not have this rather large hiatus in it.

Mr. SAULNIER. As I say, Mr. Reuss, I will check my understanding of this with the Treasury.

The CHAIRMAN. Thank you, gentlemen.

Mr. SAULNIER. Mr. Chairman, may I make just a short statement before we close about procedural matters having to do with the conduct of these hearings?

Of course, the way the committee wishes to conduct its hearings is for the committee itself to decide, but I should like to have the record quite clear as to my own willingness to discuss procedural questions at any time, fully and frankly, with this committee.

I recall very clearly the discussions that went on during Dr. Burns' incumbency. I recall very spirited discussion on both sides of this committee table, as to how best to conduct these hearings in order to implement the purposes of the Employment Act and to be helpful to the Congress.

It is my recollection, sir, that a procedure was agreed upon by the committee, and it was accepted by the Council.

My first encounter, as chairman, with this question, was in an exchange of correspondence with Congressman Patman—a very cordial exchange of letters, I might say—in which he set forth a method for conducting these hearings, as preferred by the committee, and I indicated my acceptance of his proposals.

That was, I believe, in connection with the hearings, Senator Douglas, on the Economic Report of the President for January, 1957.

In 1958 and in 1959 no question was raised about those procedures. And in view of the exchange of letters, Senator, which we had just prior to these hearings, I am a little surprised at the unhappiness that you express with these procedures.

I must say, sir, it comes as a considerable surprise to me, and I am saddened by it, because I am very anxious that these hearings be conducted in a way that is just as useful to the committee as can be. And I can assure you, sir, that if you had raised any questions with me prior to our coming up here this morning for these hearings I would have been happy to sit down and talk with you about them.

The CHAIRMAN. Have you finished?

Mr. SAULNIER. Yes, I have, sir.

The CHAIRMAN. It may be that under the pressure of time and work, we have not reexamined this issue upon which the committee voted some years ago. It was my understanding that the administration and the Council took the same position that Dr. Burns took, namely, that it wanted the testimony continued in executive session. And in a desire not to further complicate the situation and to be as cooperative as possible, I extended an invitation, as chairman of the committee, on the same terms that we had observed in other years.

But as an individual member of the committee, I have come to feel that either the procedure should be changed or that the sessions between us should be discontinued. And since we were proceeding under the agreement which had been reached some years before, as an individual I felt that I, like Congressman Bolling, should register my own feeling, by nonparticipation, which was done without any animus toward the members of the Council itself. This is a matter which can go over until next year. If the situation is unchanged, it is my present feeling that I would move in executive session of this committee that we content ourselves with receiving the printed report of the Council and examining that printed report and making our printed reply to it, but that as matters have developed, it is more or less a waste of time both for you—for your time is precious—and for us, to continue on the present basis.

Mr. SAULNIER. I hope, Mr. Chairman, that in any discussions your committee has of this matter you will bear in mind the readiness of the Council—and I am sure that in this matter I speak for both of my colleagues—to discuss procedural matters at any time.

Representative CURTIS. I would like to say simply this: I do not regard it as a waste of time. I do agree that if the chairman of the committee and some of the majority members do not want to interrogate the Council when they come up here, it is a waste of time. But there are many questions that can be asked about the report that are meaningful and publication of the response, which would be public, would be very helpful. But each person is entitled to his own feelings.

(Whereupon, at 11:45 a.m., the hearing was recessed to reconvene at 2 p.m., same date.)

JANUARY 1960 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, FEBRUARY 2, 1960

U.S. CONGRESS,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to recess, at 2 p.m., in the Old Supreme Court Chamber, the Capitol, Hon. Paul H. Douglas (chairman of the committee) presiding.

Present: Senators Douglas and Javits; Representatives Patman, Reuss, Coffin, Curtis, and Kilburn.

The CHAIRMAN. Mr. Martin, we appreciate very much your coming here. You are always a courteous and even-tempered witness. We hope that you have had a very pleasant summer and that you have come back to your tasks of this winter in good health and good spirits. We are very happy to have you here.

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM; ACCOMPANIED BY RALPH A. YOUNG, SECRETARY, OPEN MARKET COMMITTEE

Mr. MARTIN. Thank you, Mr. Chairman. It seems to me that perhaps the most helpful contribution I can provide to your committee's annual review of the President's Economic Report is to make some supplementary comments on financial and monetary developments over the last year.

Our financial environment changes constantly, as this committee knows well, but some of the changes that took place last year were dramatic indeed.

During 1959, credit expanded by $60 billion in all—one-third more than the previous peacetime record. Mortgage debt, most of it for housing, increased by a record $19 billion. Consumer credit outstanding rose about $6.5 billion, equaling the previous record of 1955. New borrowing by State and local governments continued in near-record volume, and new borrowing by the Federal Government exceeded all peacetime records. At the end of the year public and private debt was at the highest level in history.

The American economy and the American people would be in a very different and a vastly worse position today if this enormous expansion of credit had been financed by the large-scale creation of additional funds by the banking system and a consequent rapid and inflationary increase in the money supply.

Fortunately, that danger was averted—in 1959 at least. To date, the task of supplying this huge demand for credit without severe

inflationary consequences has been accomplished chiefly by the sound and democratic process of letting those who would borrow provide those who would save with an inducement to risk voluntarily the loan of their savings. The role of the banking system, which obviously is influence greatly by Federal Reserve policy and operations, has been held to that of an intermediary between borrowers and savers.

Let me illustrate the working of this process by referring briefly to the events of 1959 as they reflected in the Federal Reserve's flow-of-funds accounts, a body of quarterly published data developed in part as an outgrowth of investigations set in motion by one of your subcommittees into the need for improved statistical information.

The commercial banks, it is true, did expand their loans in 1959 by almost $12 billion—thereby equaling the previous record of 1955. The important thing for the economy, however, is that the banks raised the funds for this lending in large part by selling Government securities they owned to the nonbank public.

Thus, the banks performed an intermediary service by obtaining funds from savers, to whom they transferred investment securities, and by passing the funds on to others who had a need to borrow. This flow of funds from savers to banks to borrowers did much to assure that the need for credit was met without a dangerous increase in the money supply. It did, however, bring about an increase in the turnover or rate of use of the existing money supply and, by so doing, produced much the same economic and financial effect as would have been produced by a modest increase in the money supply without the accompaniment of a faster rate of use.

The activity last year of the nonbank public—meaning for the most part consumers and business concerns—in supplying borrowers with funds through the process of investment was truly extraordinary, and it did not stop with the purchase of Government securities sold by the banking system. The upswing in this activity shows up strikingly in the flow-of-funds data that I mentioned earlier. There, it appears that consumer and business investors increased the net amount of their purchases made directly in securities markets from about $4 billion in 1958 to almost $20 billion in 1959—a jump of 400 percent in a single year.

The efficient and economically healthy flow of funds from savers to borrowers, directly and through intermediaries, did not come about without a price. The price was, of course, a rise in interest rates. These rates, representing a penalty to those who use someone else's money and a reward to those who save and risk their funds in loans and investments, rose in some instances to the highest levels in three decades. What happened is readily apparent: the pressure of demand for funds arising from a combination of forces—a large Federal budget deficit, high residential construction activity, rising expenditures for consumer durables and for inventories and to some extent fixed capital, plus the continued high level of expenditures by State and local government on community facilities—converged to bring about a competition to borrow that drove interest rates upward; the rise in interest rates, in turn, operated to induce the savings and investment necessary to supply borrowing demands. In summary, the direct effect of the greatly enlarged credit demand was to bid up interest rates generally and to cause some changes in the relationship of inter-

est rates among the different credit markets; the resultant effect was to draw more funds into the credit market and to shift some funds from accustomed uses.

Let me add something here to what I said about the banking system's service in 1959 as an intermediary between the saving public and the borrowing public. On the one hand, the saving public, besides purchasing a large volume of securities as I described, increased their time deposits by about $1.5 billion. On the other hand, the borrowing public increased the amount of their loans obtained from commercial banks by nearly $12 billion. To raise funds to meet the heavy demands on them for loans, the commercial banks sold about $8 billion of their Government security holdings in the open market, while the nonbank public, as stated earlier, was increasing their purchases in that market. Thus the banks, in effect, drew out of the market, from individuals and corporations not engaged in lending, the funds to meet the specialized credit demands of borrowers—as, for instance, many small business concerns—who could not themselves have raised funds in the market because their needs were unsuitable for general market participation.

The vital role that the Federal securities market plays as a clearinghouse for credit flows is apparent in the circumstances described. In 1959, this role was much larger than in other recent years. Federal net borrowing of $11 billion and bank sales of Governments of nearly $8 billion required absorption of around $19 billion in Federal securities by other investors. This, taking into consideration that the Treasury was having to raise new funds while shifts were taking place in Government security ownership, goes a long way toward explaining the rise in both long- and short-term rates that we experienced during the year. It is also illuminating evidence of the responsiveness of nonbank investors to attractive interest yields.

The relation of Federal Reserve policy to changes in interest rates is often misunderstood. Federal Reserve operations to release or absorb bank reserves unquestionably influence short-term and also long-term interest rates, but the extent of this influence is easily exaggerated. Monetary policy is effective only so long as it works in general consonance with the economic realities underlying the situation. These realities include the basic demands for funds, whether to meet seasonal needs, other short-run needs, or for capital formation, and the basic supply of funds through saving. Federal Reserve actions cannot for long enforce rates of interest on the market that are either above or below the rates that maintain a balance between saving and investment.

Changes in the rate of monetary growth can represent only a very small part of the total flow of funds through credit markets. If the rate of monetary growth were raised with the specific objective of adding to the supply of funds in an attempt to keep interest rates down, the additional dollars in the spending stream would certainly work to raise average prices. The process of monetary inflation is widely understood by both savers and borrowers. Such action would generate expectations of further inflation on the part of both groups. The incentives of the marketplace, present and prospective, would unquestionably tend to increase borrowing and discourage saving and in all likelihood rates would increase.

In the longer run, the way that monetary policy can contribute to a lower level of interest rates is through its role in maintaining a stable value for the dollar. It is only in an environment of confidence in such stability that savings will accumulate and credit will flow in an orderly way and in expanding volume. Efforts to maintain an artificial level of interest rates, either too high or too low, can only lead to cumulative financial disequilibrium, first distorting and then disrupting healthy economic growth.

Whether monetary policy as administered by the Federal Reserve System has been, at particular times, too easy or too tight is a matter of judgment. At one time or another, we have no doubt erred in some degree in each direction. But the System has consistently endeavored to cultivate confidence in the stability of the dollar—by combating deflationary tendencies in periods of slack and inflationary pressures in periods when resources were being intensively utilized.

I want to emphasize again that the Federal Reserve System wants low and not high interest rates; it wants as low a level of interest rates as is consonant with sufficient savings to finance the investment necessary for desirable and rapid economic growth. We cannot say that a steadily swelling stream of savings and investment is the only essential for satisfactory growth, but, especially in a country where the natural resources are already highly developed, it is a vital element.

Record of economic growth

The subject of economic growth has received exhaustive study by your committee during the past year. It is an important subject because only growth can produce the substance with which to achieve our individual and national aspirations. At the same time, economic growth is a confusing subject because it means so many different things to different people. Some seek growth primarily as a requisite of effective defense against potential enemies. Others want it as a means of improving living standards. Still others regard growth as a way of assuring employment of a growing labor force. Transcending and including all of these, perhaps, is the idea that economic growth is needed to express the vitality of our economic and political way of life.

As economic abundance in the United States expands and is more widely shared, agreement on appropriate economic goals becomes more urgent. These goals can never be blueprinted exactly—as has been brought out so clearly in the hearings before this committee. They are not solely materialistic and they are not all subject to expression in statistical terms. They include, for example, the improved quality of our educational system and of our health services—not just additional schoolrooms or hospital beds. Despite difficulties in measuring true growth precisely with the tools now at hand, we have made some progress and now know much more about the nature of growth than was known some years ago.

Early in its existence, the Board recognized that measurement of physical output was essential for proper formulation of monetary policy, and undertook a special responsibility for the statistical measurement of industrial output and its change and growth. This, it is true, is only part of our Nation's total output of goods and services, which is measured by gross national product. However, in an advanced economy, in which industrial activity is a dynamic central

element, growth in the physical volume of industrial output merits special study in its own right because of its central role as a force shaping total growth.

When I appeared before this committee last summer, I noted some preliminary findings of the recent revision of the Board's index of industrial production, principally the greater industrial growth shown by the newly revised index. Since then, the final results of the new index have been published, thus supplementing the tools for analyzing past and future changes in the industrial sectors of our economy.

Industrial production is the output of real goods produced by our factories, mines, and electric and gas utilities. Our revised index shows that, since 1947, industrial output has grown 4.1 percent per year, as compared with 1.7 percent for population. This is a growth in real industrial output per capita of over 2 percent per year. In other words, we are producing 31 percent more industrial product for each man, woman, and child in America than we were at the beginning of the period. Output per industrial worker has increased even more rapidly—at the rate of 3.7 percent per annum over the same period.

The revised index of industrial production also introduces a new grouping of total output. Output measures for finished goods have been grouped into the broad market categories for consumer goods and equipment, and the measures for output of materials have also been grouped together. Briefly, this new grouping suggests that over postwar years, civilian production, and particularly the production of consumer goods, has expanded almost without any evident slackening in pace at a rate of growth of 3.7 percent. Moreover, the cyclical interruptions in the output of civilian goods, especially consumer goods, have been relatively small. It is mainly in the production of equipment, including defense goods, that output has shown greater fluctuation about its expanding trend.

Conditions required for continued growth

While industrial growth, as measured by the production index, reflects physical volume of output, many measures of growth are expressed in terms of current dollars. We must constantly guard against mistaking increases in dollar magnitudes for real economic growth. It is sometimes suggested, when the rate of expansion slows down because the economy is operating close to capacity, that a more rapid expansion of bank credit and money would stimulate greater aggregate output. In fact, such an attempt would only lead to a bidding up of costs and prices as various sectors compete for limited resources. It is true that this would increase temporarily the gross national product measured in current dollars, but it would not involve any real growth. Quite aside from its other evils, inflation brings about misapplications of resources that actually reduce the true value of current production. There must be sustained confidence in a stable dollar for such adverse developments to be avoided.

Sound growth depends on a number of factors besides confidence in a stable dollar. In my own view, the following are the chief supplementary factors:

1. Balanced and sustained demands for labor and for the products of business;
2. Improvement in technology and skills;

3. Adequate capital formation based on voluntary savings;
4. Greater mobility of resources; and
5. Sufficient flexibility of individual prices.

Although there have been three postwar recessions, demands for labor and for the products of business have been reasonably well sustained over this period. During each of these recessions, stability of consumption helped to stimulate early revival. This stability in final demand encouraged entrepreneurs to maintain capital expenditures at surprisingly high levels even during temporary recessions. Such expenditures fluctuated moderately considering their long history of instability.

How much further the process of economic stabilization can be carried remains an uncertain issue. All men of good sense want to see our economic resources used fully and all men of good will want to have employment opportunities available for those willing and able to work. Satisfactory economic growth and reasonable price stability are not only compatible goals, in my view, but they are necessarily interdependent. At the same time we all recognize that some fluctuations in prices and employment are probably unavoidable and that, in the present state of the economic arts, it is hard to see how complete stability could be achieved without stifling some developments in our economy potentially favorable to growth.

Advancing technology and improvement of skills depend on educational processes and the general cultural environment. Our national pride has been pricked by discovery that other nations have beaten us in some aspects of technological development. This evidence is found not only in military hardware but also in the mounting competitiveness of the rest of the world. Products from abroad are increasingly penetrating our markets. This challenge, however, may well provide the stimulus for new achievements on our part.

If we are to maintain our competitive position in the world, we must also make regular additions to our productive capital and to our efficiency. Adequate capital formation depends both on the drive of business to make the capital investment and the availability of adequate funds from voluntary saving.

Mobility of resources must receive continuous attention. Near the top of successive postwar peaks in activity, unemployment has tended to be somewhat higher. In part, this may be due to structural imbalances growing out of the problem of transferring the labor force from industries made obsolete by growth to areas of higher labor demand. Such imbalance may also stem from the problems of adapting workers to the technological and sociological demands of the service industries, which are the more rapidly growing sources of urban employment.

Flexibility in the shifting of resources, of great importance for maximum growth, is extraordinarily difficult to achieve. One of the effects of growing productivity is to reduce the amount of resources required in particular industries, especially those in which end-product consumption, such as consumption of food, grows at a slow, steady rate. The process of moving resources aggravates our cyclical difficulties and creates a problem of structural unemployment. Steps to lessen the economic loss to the Nation and the hardships for individuals resulting from shifts in the pattern of production are an important public responsibility.

If we are to be able to continue to rely on the price mechanism to effect the necessary adjustments in a growing economy, prices of both end products and the factors of production must move freely in response to shifting demand and supply conditions. Imperfections in the price mechanism must be rooted out wherever they may exist, if our free enterprise economy is to realize its full potential.

Prospects for 1960

In early 1960 the economy continues to show a sharp pickup from the period of hesitation caused by the steel strike. Economic activity is vigorous and prices are reasonably stable. Nevertheless, it is possible we may encounter a renewed spiral in the upward movement of prices, or, perhaps, find that the underlying strength in the situation is not so great as most observers now feel. In these circumstances, all of us are faced with a particularly sensitive problem of maintaining prosperity by endeavoring to prevent either a renewal of inflationary pressures or development of deflationary tendencies.

I sincerely hope that our part in this task as monetary authorities can be aided by a healthy budget surplus of an amount at least as large as the one outlined in the President's budget message. Experience since 1957 suggests that a surplus of this size is a minimum condition of reasonable fiscal health. The relatively brief decline in economic activity that occurred in 1957–58 resulted in a deficit of over $12 billion in fiscal 1959. If a level of economic activity as high as marked 1959, and which is projected in the budget estimate for 1960, results in a barely balanced budget in 1960 and a budget surplus of no more than $4.2 billion in fiscal 1961, the average result of the full period is a net deficit.

Such an outcome would hardly represent symmetrical economic policy. It would therefore appear that larger budget surpluses are needed in times of prosperity if we are to avoid having to make regular and persistent increases in the public debt. The relatively favorable outlook for balance between saving and investment in the period ahead, with the accompanying prospect of less pressure on the rate of interest, depends in large part on the improved fiscal position of the Federal Government.

I doubt that anyone could be more aware of the real limitations of monetary policy than are the members of the Federal Reserve Board. It is, however, the area of responsibility which has been given to us, and in the discharge of that responsibility it has seemed to us that the most constructive contribution monetary policy can make to the vigorous, healthy growth of the economy in the present circumstances is to maintain confidence in the value of money, and thus encourage people to save and invest in the basic capital improvements that add to our Nation's productive strength.

At this point I want to refer to some statements that I made in the closing portion of a letter to Chairman Douglas on December 9:

> My interest in a monetary policy directed toward a dollar of stable value is not based on the feeling that price stability is a more important national objective than either maximum sustainable growth or a high level of employment, but rather on the reasoned conclusion that the objective of price stability is an essential prerequisite to their achievement.
>
> I want to emphasize that I am most concerned with the preservation of freely competitive markets and the correction of any institutional imperfections which

exist in the working of the price mechanism. While such imperfections cannot be corrected simply by a sound monetary and fiscal policy, they surely cannot be corrected by an unsound financial policy.

Nor does a sound general monetary policy necessarily, in itself, accomplish the optimum distribution of loanable funds among various sectors of the economy. It is not only the right but the duty of government to assure that socially necessary programs are adequately financed. But, again, this objective can never be well served by unsound general monetary or fiscal policies. If, as a matter of public policy, the financing of school construction, for example, should have an overriding priority in the allocation of resources, this can be accomplished in a number of ways, but we can be sure that it would not be accomplished by the general expansion of bank credit and money.

In conclusion, I should like to add a word about what monetary policy can and cannot do. It cannot effectively peg interest rates. It cannot prevent monopoly. It cannot assure that the financial needs of all socially desirable activities are met without intervention by Government. It cannot be relied upon to cover Federal deficits. Alone, it certainly cannot assure either stability or growth.

What a correct monetary policy can do is to foster confidence in the dollar, so that our people can and will save and invest in the future with reasonable assurance that their plans will not be frustrated by irresponsible changes in the value of money.

The CHAIRMAN. Thank you very much, Mr. Martin.

I noted with great satisfaction in your statement in which you say that larger budget surpluses are needed in times of prosperity.

This is the main burden of the majority report of our committee on growth, production, and stable price levels. While I know that the means to do this are somewhat outside your scope, I would like to point out that the majority was very specific in indicating how they thought governmental revenue should be increased by plugging loopholes in the tax structure, and emphasizing the fact that in periods of prosperity, these should be used in large part to retire a portion of the public debt; so that we are in agreement on general aims. I would like to point out that the majority was quite specific in indicating the means whereby this was done. So we hope that we may have your platonic support, at least, in the future, as we move to the reform of the tax structure.

Now, the second question I should like to raise is this: We also want a stable price level. There is a secular growth in the economy. Is that not true?

Mr. MARTIN. That is right.

The CHAIRMAN. You say that there has been a per capita increase of productivity of 31 percent since 1947 and an increase in total volume of about 56 percent. Is that not true?

Mr. MARTIN. I think that is right; yes.

The CHAIRMAN. Now, if you subdivide that period from 1947 to the end of 1959, do you not find it falls into two periods, one the period from 1947 to 1953, where according to your own index the increase was from an average of 100 to 138, and then the six following years, where the increase was from 138 to 156, or 18 points, or about 12 percent; in other words, that the rate of growth in the first 6 years was almost three times as rapid as the rate of growth in the following 6 years? Is that not true?

Mr. MARTIN. I think if you divide them, that is so.

The CHAIRMAN. Yes, I know. It is just like the President's Council of Economic Advisors—you take 1946 or 1947 as the jumping off point and do not point out the fact that the rate of growth in the first 6 years of this period was very much greater than the rate of growth in the subsequent period. You are dealing with industrial production, and the Council dealt with gross national product.

Mr. MARTIN. I think that is correct. I merely want to emphasize what I frequently do here, that this is a process that goes on.

The CHAIRMAN. I understand. I also want to emphasize that the process was not continuous, and that the rate of growth slowed down very markedly after 1953.

Did the gentleman from Missouri have a comment that he wanted to make?

Representative CURTIS. Yes, I made the comment. I said, "For heaven's sake." I would say the comment is this: The gentleman must recognize that this country was at war in 1953, and if he wants to take a war year as an example of growth, then let him take the burden of that and say that that is the way he would like to get economic growth in this country.

Representative PATMAN. May I suggest that that war that was going on was on a pay-as-you-go basis, probably the only war in history that was fought that way.

The CHAIRMAN. Now, if we assume that there is a long-time rate of growth of approximately 3 percent, would you feel that the total money supply should be expended at the rate of approximately 3 percent?

Mr. MARTIN. Not at any precise time.

The CHAIRMAN. Over a long period of time?

Mr. MARTIN. It is a combination of money supply with turnover money with which one has to deal in actual situations, so that it is difficult to be specific about it, Senator, even for a long period of time. That is where I disagree with Mr. Friedman and others who would pick a rate of 3 or 4 percent and say that that is a constant.

The CHAIRMAN. As production increases, do you think that the supply of money should increase?

Mr. MARTIN. I think that we should have some relationship between the increase in the supply of money and that of production.

The CHAIRMAN. Then as production and gross national product increase, do you think that the supply of bank credit should increase?

Mr. MARTIN. Yes. But I also think that the basis of plant and equipment expenditures should come and must come out of savings, not out of bank credit.

The CHAIRMAN. Now, then, how would you increase the supply of bank credit?

Mr. MARTIN. Well, we have all of the tools that you are familiar with.

The CHAIRMAN. In the past, you have primarily advocated increasing the money supply, in these last few years, by lowering reserve ratios, and the discussion which we had last summer on this point was largely between you, on the one hand, advocating an increase through the lowering of reserve ratios, and between Congressman Reuss, Congressman Patman and myself, on the other, advocating open market operations. Now, we have both had a chance to think over

51708—60——12

our positions since then. Do you still feel that the secular increase in the supply of money should be affected by lowering reserve ratios?

Mr. MARTIN. Not at all times.

The CHAIRMAN. But over the long period?

Mr. MARTIN. Let us put it this way. Between last summer and now, I must confess that I am unregenerate. In other words, I have not substantially changed my view from what, I testified to, then.

The CHAIRMAN. I am correct, am I not, in thinking that last summer you felt that in the main the long-time increase in the supply of bank credit should be affected through a lowering of reserve ratios, in the main?

Mr. MARTIN. I would think that, if we were facing a recession period, the most effective device for stimulating credit is a lowering of reserve requirements.

The CHAIRMAN. Of course, what you have done in the past is that every time that there is a recession, you have lowered the reserve ratios, but you have not raised them when revival occurs, so that the net effect is a secular decrease in the lowering of the reserve ratios. And I think you testified last summer that you felt the British and the German ratios of around 8 to 10 percent were desirable as the long-run objective.

Mr. MARTIN. Well, I have testified repeatedly that I think that a lower level of reserve requirements would be feasible and desirable. But I have not specified any specific figure as a lower limit.

The CHAIRMAN. Now, is it not true that you can get the same result in expansion of the monetary medium by open market operations as you can be lowering reserve ratios?

Mr. MARTIN. At a time of recession; no, sir.

The CHAIRMAN. But I mean over the long run. In normal periods.

Mr. MARTIN. Leaving out recession or boom—but that is what we are usually dealing with, one of the two. If you want to put it in long-run mathematical terms, I would say the answer is "Yes."

The CHAIRMAN. In a normal period?

Mr. MARTIN. In a normal period. But I merely point out that we have had practically no normal periods.

The CHAIRMAN. Well, there must be some normal period.

Mr. MARTIN. Well, I must say my job would be a lot easier if I could get a few.

The CHAIRMAN. It is either abnormal up or abnormal down? There is no abnormal down?

Mr. MARTIN. That has been the experience. And I think it would be a lot easier for me if we had more normal periods.

The CHAIRMAN. Mr. Martin, I want to suggest that I think you are obscuring fundamentally the intellectual issue. Is it not true that you can get substantially the same increase by open market operations, which will increase member bank reserves, as you can by lowering reserve ratios, enabling more credit to be extended upon the given amount of member bank reserves?

Mr. MARTIN. Well, as I have said previously, mathematically, yes. But I want to emphasize here that in the periods that we have been talking about—let us just review it, for example. We talk about the 1948–49 recession.

The CHAIRMAN. No; I would like to talk about general principles, because when you get into many particulars, you can always argue about one month or another month.

Mr. MARTIN. Well, I am perfectly willing to agree with you in terms of general principles on the mathematics of it; but I also want to point out that it is not general principles that apply in practice, and it is practical operations that we are dealing with here.

The CHAIRMAN. It is well to have general principles when you deal with practical matters, however.

Mr. MARTIN. I could not agree with you more.

The CHAIRMAN. All right. Now, is not one difference between the method of open market operations and the method of lowering reserve ratios this: that in the case of lowering reserve ratios, with a given amount of member bank reserves the member banks can create approximately six or seven times the amount of credit?

Mr. MARTIN. That is correct.

The CHAIRMAN. So that the total amount of credit which is created accrues to the member banks without the Federal Reserve getting any added share of that total amount; is that not true?

Mr. MARTIN. That is true at that point.

The CHAIRMAN. Whereas with open market operations, if the Federal Reserve buys a billion dollars of Government bonds, this will increase the lending capacity of the member banks by from 6 to 7 billion. Is that not true?

Mr. MARTIN. The same general rate.

The CHAIRMAN. But the Federal Reserve gets a billion dollars increase in capital assets out of this?

Mr. MARTIN. That is correct.

The CHAIRMAN. And this would mean that, let us say, the interest on this is $40 million a year; you give 90 percent of your profits, we will say, to the Treasury. This would mean an income to the Treasury of close to $40 million a year. Is that not true?

Mr. MARTIN. That is right.

The CHAIRMAN. So that under the Federal Reserve system of open market operations, the capital assets of the banks increase and the income of the Federal Government increases?

Mr. MARTIN. That is correct.

The CHAIRMAN. And this starts out at a billion dollars the first year, and let us say——

Or perhaps now let us get a more precise illustration. Assume you increase the money supply by 3 percent by a purchase of $750 million a year, at an interest rate of 4 percent. This means annual earnings of $30 million in the first year. The next year, however, the earnings are $30 plus $30, or $60 million. The third year, $30 plus $30 plus $30 equals $90 million. The next year, $30 plus $30 plus $30 plus $30, and so you go on. And in the course of 13 years, you set a figure running into the hundreds of millions, and, indeed, very close to a half-billion dollars. Is that not true?

Mr. MARTIN. That is true. I read your recent speech in the Congressional Record. The figures that you have there are approximately correct.

The CHAIRMAN. Thank you. I am not always accurate with a pencil, but I have some people to check my figures.

There is a rollcall coming.

Now, I will just make one final point. In other words, the open market system gives much greater revenues to the Government. Also, by the purchase of Government bonds, in these amounts, each year, does it not increase the price of bonds?

Mr. MARTIN. Well, I question that.

The CHAIRMAN. Well, the purchase of $750 million a year—does that not strengthen the market price of bonds?

Mr. MARTIN. I think you are under a misapprehension, there, Senator, if I may say so. A market for securities is not strengthened by finding out that a principal way in which the Federal Government is going to finance itself is by selling bonds in effect to itself.

The CHAIRMAN. Well, now, wait a minute.

Mr. MARTIN. That is a basic and important factor in markets.

The CHAIRMAN. Yes, but if anything increases the demand for an object, does that not generally serve to increase the price?

Mr. MARTIN. A demand that is created by the Federal Government?

The CHAIRMAN. Well, wherever it comes from, if there is an increased quantity demanded at the same price, or more will be paid for the same quantity, does this not mean an increase in the price? I mean, is this not the simple rule of market price to which you have been appealing?

Mr. MARTIN. I have been appealing to the saving and investment process.

The CHAIRMAN. No; but if in one case the Federal Reserve buys $750 million of bonds each year which otherwise it would not buy, does not this increase the price of Government bonds?

Mr. MARTIN. Not necessarily. It depends upon the budgetary position of the Federal Government.

The CHAIRMAN. All other things being equal?

Mr. MARTIN. All other things being equal. But they are not equal.

The CHAIRMAN. But we are just discussing this issue. All other things being equal, if you have the Federal Reserve buying $750 million of bonds which otherwise it would not buy, does not this raise the price of Government bonds?

Mr. MARTIN. The price of Government bonds will be improved, assuming now that there is no increase in Federal expenditures.

The CHAIRMAN. That is all right. Other things being equal. And if the price of Government bonds increases, does this not mean that the yield of Government bonds is reduced?

Mr. MARTIN. That is right.

The CHAIRMAN. And therefore the interest rate is lowered?

Mr. MARTIN. That is correct.

The CHAIRMAN. That is all I wanted to find out. Thank you very much.

I am not leaving on purpose, but there is a rollcall.

Representative PATMAN. Mr. Martin, did you see the article in Business Week under Government: "Martin, the Money Man, Heads Into a Fight"?

(In accordance with the committee discussion which took place during the morning session of February 4, 1960—see pp. 257–259—the full article is inserted in the record at p. 213.

Mr. MARTIN. I have seen it. I have not read it very carefully, Mr. Patman, but I have seen it.

Representative PATMAN. Did you happen to see it before it was published?

Mr. MARTIN. No, I did not see it before it was published, and I have no influence over Business Week.

Representative PATMAN. I noticed that the article in Business Week for January 30, 1960, at page 54, says:

> Martin's power and his importance to politicians stems from his position as head of the Nation's Central Bank, which controls the amount of reserves held by the banking system, thus determining how much money and at what price banks can lend. The crucial responsibility gives the Fed a major role in the shaping of overall economic trends and makes Martin a key figure among the Nation's policymakers.

There is no question, is there, Mr. Martin, but what the Fed does determine the money supply? At least, you consciously and deliberately determine what the maximum amount of money supply will be at any given moment. That is correct, is it not?

Mr. MARTIN. Our duty is to try to regulate the money supply.

Representative PATMAN. Now, by orthodox theory, when the Federal Reserve restrains increases in the money supply and only permits the money supply to increase at a rate less than the gross national product of the country increases, the result tends to be deflation; is that not correct?

Mr. MARTIN. Tends to be deflation?

Representative PATMAN. Yes, sir.

Mr. MARTIN. Not at all times. As I tried to point out in this paper, it has to be related to the savings-investment process, and this past year you have had an amazing demonstration of how it is possible to encourage saving at a time when the whole world is seeking savings by inducing investors to come in through higher interest rates.

Representative PATMAN. If you hold the lid on the money supply very tight while the gross national product is increasing, interest rates go up, do they not?

Mr. MARTIN. They tend to rise if we are in consonance with the underlying strength in the economy.

Representative PATMAN. Will someone hand this to the witness, please?

I would like to show you some figures on the money supply, taken from the Federal Reserve Bulletin, and some figures on the gross national product, taken from the President's Economic Report. You will note that for each year, beginning with 1946, the money supply

and the gross national product are related. In 1946, the money supply, that is, demand deposits in the commercial banks, adjusted, plus currency outside of banks, was equivalent to about 50 percent of the gross national product.

Then in the year 1947, it was brought down to 46.7 percent. Then in 1948, the money supply was squeezed further, relative to the gross national product, and was down to 42.4 percent. Then in 1950, just before February 18, 1951, the money supply was down to 39.2 percent of the gross national product.

And if you will read on down on that table, Mr. Martin, you will find as the gross national product has gone up, the money supply percentagewise has gone down. In 1950, it was 39 percent—the money supply as a percentage of the gross national product. In 1951, it was 35.6; in 1952, 35.5; in 1953, 34.5; in 1954, 35.2; 1955, 33.3; 1956, 32; 1957, 30; 1958, 30 percent; and 1959, 29.3.

Do you believe that it was in the public interest for the money supply to decrease like that in relation to gross national product?

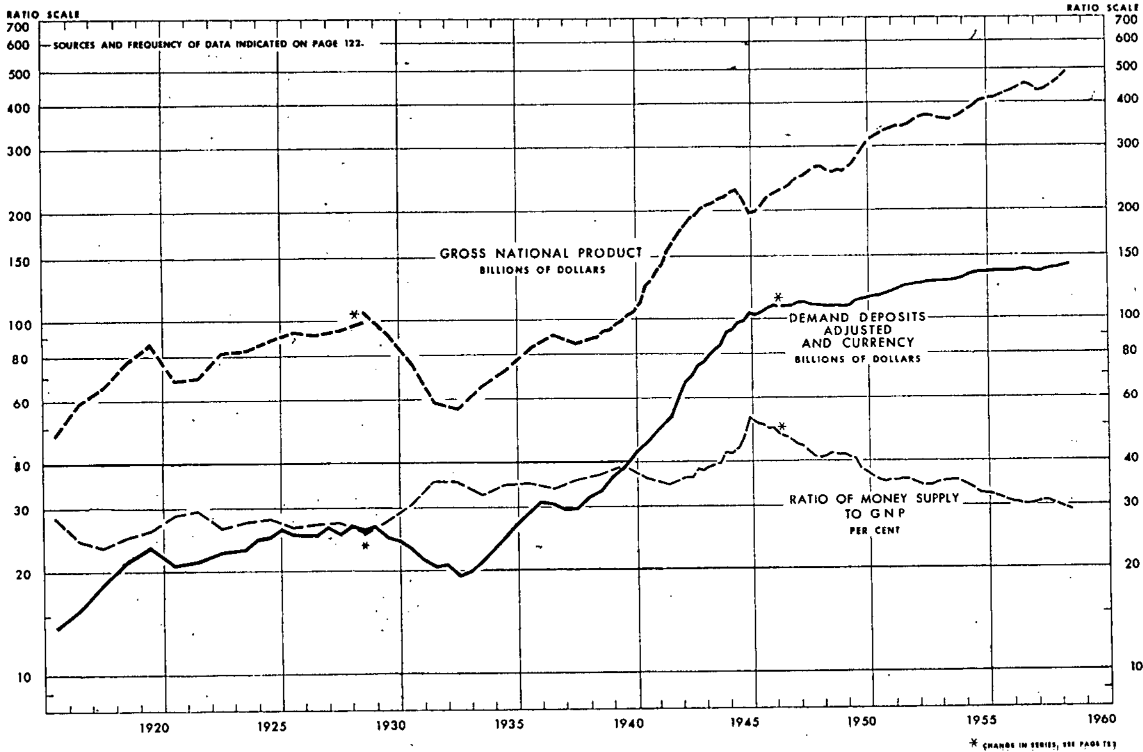
Mr. MARTIN. I would like to put this chart, gross national product and demand deposits adjusted in currency, into the record, Mr. Pitman.

It shows the ratio of money supply to gross national product all the way back to 1919. In the 1920's, the ratio was fairly stable at a level somewhat under that for 1959.

The CHAIRMAN. And that will be in the record in your testimony?

Mr. MARTIN. Yes.

(The chart referred to is as follows:)


GROSS NATIONAL PRODUCT AND DEMAND DEPOSITS ADJUSTED AND CURRENCY
RATIO SCALE
RATIO SCALE
SOURCES AND FREQUENCY OF DATA INDICATED ON PAGE 122.
700
600
500
400
300
200
150
100
80
60
40
30
20
10
GROSS NATIONAL PRODUCT
BILLIONS OF DOLLARS
DEMAND DEPOSITS
ADJUSTED
AND CURRENCY
BILLIONS OF DOLLARS
RATIO OF MONEY SUPPLY
TO GNP
PER CENT
1920
1925
1930
1935
1940
1945
1950
1955
1960

Representative PATMAN. Now I want to finish my question. My question is this: Assuming that these computations are right, I will ask you whether this record of reducing the money supply relative to the gross national product indicates that the Federal Reserve had lost control of the money supply in the postwar years.

Mr. MARTIN. When you say "lost control," there are a great many factors in the money and credit market other than the Federal Reserve, as we have pointed out a number of times.

Representative PATMAN. That is what we are talking about.

Mr. MARTIN. I do not think we have lost control. I do not want to engage in semantics on this, Mr. Patman, but I want to point out, on this matter of the money supply: We talk about tight money. As I tried to point up in my statement, in 1959 credit expanded by $60 billion. That is one-third more than the previous peacetime record. That is not evidence of an inadequacy of money supply.

Now, the solution to the tight money problem will depend on how we work to stimulate saving, which the whole world is seeking today in increasing quantity. Just day before yesterday I had a fellow in from a small island in the Bahamas who said if they did not get $40 million day after tomorrow, they would not know what to do. In Africa, they are asking for billions. We have got to stimulate, do everything we can to stimulate saving, and see that in the period ahead of us the world builds out of savings and not out of bank credit. And our efforts in the Federal Reserve should be to minimize the substitution of bank credit for savings.

Representative PATMAN. I do not want to take up more time than I should. I do want to ask Mr. Martin a lot of questions—questions I prepared for this interrogation.

Mr. MARTIN. And I have prepared for you, Mr. Patman. [Laughter.]

Representative PATMAN. Thank you. And I would like to know: Shall we have the rule that for the first go-round we will have 10 minutes for each member, and after that kind of open it up? Is that all right? Or how do you want to do it?

Representative CURTIS. I think that would be fine.

The CHAIRMAN. Then catch-as-catch-can afterwards?

Representative PATMAN. No; after that ask questions as long as they are material and germane.

Representative KILBURN. On that, Mr. Chairman, I would agree with anything you want, but when you take 10 minutes apiece, the next time it comes to Mr. Patman's turn, we will go on to 6 o'clock.

Representative PATMAN. Maybe we would go on to 6 o'clock tomorrow morning.

Representative KILBURN. There would be no second go-round.

Representative PATMAN. Yes, there will be. There are only one or two witnesses that I want to ask questions. And I feel overall I have probably taken less time than probably you have.

Representative KILBURN. Not less than I have.

The CHAIRMAN. Would this be satisfactory? Ten minutes on the second go-round, and then for the next go-round 20 minutes?

Representative PATMAN. And then open it up. That will be all right.

Representative KILBURN. Mr. Patman, if you want me to, I will give you my time.

Representative PATMAN. Well, you do not take enough, Mr. Kilburn.

The CHAIRMAN. I think you have taken 6 minutes, so you will have 4 minutes longer.

Representative PATMAN. Thank you, sir.

We often read statements to the effect that: In the pre-"accord" period, in order to maintain yields on long-term Government bonds at no more than 2½ percent, the Fed was forced to buy large quantities of Government securities in the open market. Since the Fed increases bank reserves when it buys Government securities, this buying of Government securities in order to maintain what is called an artificially low rate, caused inflation of the money supply.

I will now read from the Board's annual report for 1958. The first column of the table there shows the total of U.S. Government securities held by the Fed outright plus those held under purchase agreements, although the amount of these held under repurchase agreements was relatively small in this period.

Now, remember: We are told that the Fed had to buy enormous quantities of Government securities in the so-called bond pegging period. You remember that. Now, these figures, which are your figures, show that in 1945 you had $24.2 billion in Government securities; in 1946, $23.3; in 1947, $22.5; in 1948, $23.3; in 1949, $18.9; in 1950, $20.8.

In other words, the Fed did not increase its holdings of Government securities in these postwar years up to 2 months before the accord. Rather, it made a net reduction in its holdings of Government securities, the reduction amounting to approximately $3½ billion.

Is that correct?

Mr. MARTIN. Those figures are correct. But that must be related to the Federal budget, of course, during the period. We have a debt today getting on to $300 billion, whereas then we had a lower debt.

Representative PATMAN. Now, in view of all the misunderstanding and erroneous statements being made about what was required to maintain a maximum yield of 2½ percent on Government securities, would you care to engage in some public education and enlightenment by announcing that the Federal Reserve did not have to buy huge quantities of Government securities in the post war period in order to maintain the 2½ percent rate, but rather it maintained this rate while reducing its holdings of Government securities by 3½ billion?

Mr. MARTIN. Mr. Patman, those figures are completely misleading unless——

Representative PATMAN. Wait just a minute. They are correct figures, are they not?

Mr. MARTIN. Those are correct figures.

Representative PATMAN. All right.

Mr. MARTIN. Let me say a word about the preaccord period. I happened to be Assistant Secretary of the Treasury at that time and I know that period very well.

The pressure on the Government securities market with the peg at par and 22–32 became virtually overwhelming and, as Senator Douglas knows very well, because he was familiar with that period and played a great part in it, the accord——

The CHAIRMAN. Mr. Martin, I am very glad you said that. This may not endear me to my good friend from Texas, but I have been accused of being a demagog and trying to peg the interest rates on Government bonds. Would you give me a certificate of good character on this point?

Mr. MARTIN. I will give you a certificate.

Representative PATMAN. I am going to have to say a word. You have carried this accord too far.

The CHAIRMAN. First I want the certificate.

Mr. MARTIN. You have the certificate.

The CHAIRMAN. The Chicago Tribune, please pay attention.

Representative PATMAN. I want to read this from Business Week. It says:

> Some Wall Street observers think that, despite his convictions, Martin will avoid a headon fight by easing credit some time later this year.

I hope Senator Douglas listens to this.

> They reason that he does not want to jeopardize the administration's chances in the election. In 1952 campaign, he delayed putting through a rise in the discount rate until after Eisenhower's victory. This they claim may happen again.

Mr. MARTIN. Just so that there will be no misunderstanding, and in complete good nature, Mr. Patman, I deny what that article says.

Representative PATMAN. I do not blame you. I would, too, but I think they have just corroboration for saying what they did.

The CHAIRMAN. Mr. Curtis.

Representative CURTIS. I do not think we should leave it on that note. I thought I heard that correctly. That was amplification, was it not, that these decisions were made on a political rather than an economic basis?

Representative PATMAN. From a Republican political campaign basis.

Representative CURTIS. I am not talking about that. I am talking about the seriousness of the charge. Levity is good and I like it, too, but I think the record should be very clear.

Mr. MARTIN. I want the record to be very clear that I deny such an insinuation and such an implication and I hope, Mr. Patman, that you do not believe it.

Representative PATMAN. I have no personal difference with you, Mr. Martin, but I think that Business Week had a lot to justify this. Every move that you have made as Chairman of the Board on the question of interest rates, for instance, where you have had a choice you have chosen the side of the high interest side.

In the entire period since 1951 you have not one time raised reserve requirements of the member banks—not once—but every time you have lowered them so as to give the banks more free money, and consequently less Government securities in the Fed's portfolio.

I say that there is a lot of justification for saying that you took the side that led to high interest and that was in the direction the Eisenhower administration wanted every time. I have never known you to cross it. If you have, I would like to know about it.

Mr. MARTIN. I do not think we ought to spend time on when I have agreed and disagreed with the administration. I do not think that that is really what is called for.

I want to put on the record here what I think you know, which is that I have called my shots and the Federal Reserve Board has called their shots, whether wise or unwise, according to their lights as they saw them in terms of the best interest of the people of this country without any thought of political benefit.

I am not running for office and I do not intend to run for office.

Representative PATMAN. I wish you were. If you were, your decisions would probably be different.

Mr. MARTIN. I just want to get it on the record and I say this with complete good nature, but I hope you do not think that I am the type of individual that you are implying in saying that there is justification for that sort of a charge.

Representative PATMAN. I say that every time you have a decision to make and one alternative is on the side of the people and low interest, and the other alternative is on the side of the bankers and high interest, you have chosen the side of the bankers and high interest. There is a lot of justification for that charge.

Mr. MARTIN. That just is not so.

Representative PATMAN. That is my statement.

Mr. MARTIN. I would like to have a certificate of good character there. Evidently you do not want to give me one.

Representative PATMAN. I do not impugn your honesty or integrity. I just say that your judgment has been bad and on the side of helping the big banks.

Representative KILBURN. I ask for a point of order.

Representative PATMAN. And against the interest of the people.

The CHAIRMAN. I am going to increase the quota of time of Congressman Curtis to 14 minutes.

Representative CURTIS. No, Mr. Chairman, I do not need that much time.

I was hoping this thing would get on the proper plane, a discussion of the economic issues involved here. I am sorry that Congressman Patman has sought to imply that a good Democrat, as is my good friend from St. Louis, the Chairman of the Board is——

Representative PATMAN. Well, excuse me.

Representative CURTIS. The point I make is that I am sorry it got on the political note. I will be happy to engage in political debate on the floor of the House with the gentleman from Texas on this or any issue but I do not think that the Joint Economic Committee is the place for it.

I want to say, Mr. Martin, that certainly this statement and all your career indicates, just as you have said, that you call your shots as you see them. I happen to be in the nice position of agreeing essentially with what you state. However, if there is similarity in our thinking or similarity in the thinking of the administration and you on the subject, it is not collusion. I object because I know there is not. We can have honest differences of opinion in this area without implying that someone who is not in the arena, and your job is not in the political arena, should be motivated by other than the economic facts as he sees them.

I have only one or two comments. I do want to commend you for this statement. I thought it was excellent and gives a great deal of food for thought and puts it in the right context.

I was pleased to have Senator Douglas emphasize his agreement with your statement on the need for large surpluses in times of prosperity and emphasize that the majority of this committee is on record for that. My hope is that the majority on this committee of the majority party will be able to persuade their colleagues in both the House and Senate who already are dreaming up ideas of where they can apply this proposed 4.2 surplus for further Federal expenditures, to hold the political line on the budget.

I am satisfied that we have almost a solid Republican vote on the issue of holding the budget as was proven in the last session of this Congress time and again, particularly on the public works bill.

Now, on the other side, the revenue side, I wish, too, that the majority would take action if they are so concerned about tax revision, and Lord knows I am, and I might say I am critical of our administration for not coming forward with a more comprehensive program of tax revision. I think it is badly needed, but I must confess a little bit of sympathy when Chairman Douglas and others of the majority, as I have heard them say on the floor of the House the other day start out as their keynote—oil depletion as one of their keynotes.

If you can persuade Mr. Johnson, the leader of the Senate, or persuade the Speaker, Mr. Rayburn, to come along with that I think the administration will be glad to look at it.

I know that we have a bill over in the House that the Treasury recommended in the area of depletion allowances, the cutoff period. I appeared at the hearings and suggested that it was difficult to discuss cutoff periods without discussing percentages. The hearings closed very quickly after that suggestion was made.

I might say that I am on record on this question of oil depletion. I happen to think it is out of line and needs revision.

Representative REUSS. Will the gentleman yield?

Representative CURTIS. Yes, I will yield.

Representative REUSS. Can you do anything to get the administration to adopt your admirable views against depletion allowance?

Representative CURTIS. Yes.

Representative REUSS. Like recommending a decrease in allowance?

Representative CURTIS. I think this. I have stated this many times. Where the depletion allowances should be requires some real study in my judgment. I do not agree, if this is Senator Douglas' position, which I am not sure it is, that there should be no depletion allowance.

The CHAIRMAN. No, that is not my position.

Representative CURTIS. Then we are in accord. I simply look upon that as a differential put in the tax law which has become, through passage of time, through an increased knowledge in geology, a preferential treatment. This should be reviewed and should have been reviewed some time ago. That is the same way I feel about co-op taxation, another loophole.

Of course, what might be my loophole, to another person may be an area for applying a differential.

Tax on mutual savings banks and savings and loans is another, I have a bill on that. There are many areas of tax revision closing loopholes, if you please, that in my judgment should have been passed a long time ago, but it is very difficult to put that into the political arena under the present setup.

The gentleman's party, Mr. Chairman's party, is in control of both Houses of Congress and in control of the Ways and Means Committee. I think almost all members on ways and means support some comprehensive tax revision in their speeches.

We on Ways and Means held extensive hearings on general tax policies last fall and then the Chairman announced that nothing would be done for 1960, which I regret.

All I say is that if this question of tax reform is going to be thrown into the political arena, let us throw it into the political arena in a fair way.

I regret to say that the Chairman's party is so split that they just cannot agree on any policy and is, therefore, not in a very good position to criticize the administration.

One thing that I do see is that we can maybe hold the line on a 4.2 surplus. I gathered from your statement that you feel that that is a very important factor in the projections for 1960 as to whether or not we are going to be able to finance the growth that we presently anticipate.

Mr. MARTIN. I do, definitely.

Representative CURTIS. And also, as I understand your position, it very much relates to the question of being able to maintain price stability.

Mr. MARTIN. That is correct.

Representative CURTIS. May I ask you one question? Do you think that, if possible, the surplus should be larger?

Mr. MARTIN. I do.

Representative CURTIS. I would be very happy to try to work on that, too.

Thank you.

The CHAIRMAN. Since two Democratic members started the questioning, Congressman Kilburn, you may proceed.

Representative KILBURN. Mr. Chairman, there do not seem to have been may questions addressed to the witnesses on the subject, or in the field of his skills. I am always delighted to hear you, Mr. Martin. I am sorry, however, that this committee seems to be increasingly taking a political slant on things instead of sticking to its guns on the economic situation.

I certainly resent any magazine or any member of this committee implying that your actions are ever governed by politics. I do not think any sensible or right thinking person in this country thinks so for a minute. That is all, Mr. Chairman.

Mr. MARTIN. Thank you, Mr. Kilburn.

Representative REUSS. Mr. Chairman, in accordance with my usual policy, I am going to deal just in economics, no politics, maybe a little sociology.

I want to commend you, Mr. Martin, for your fine and forthright statement on page 15 of your written statement. I would like to read it again:

> It is not only the right—

you say,

> but the duty of Government to assure that socially necessary programs are adequately financed. But, again, this objective can never be well served by unsound general monetary or fiscal policies. If, as a matter of public policy, the financing

of school construction, for example, should have an overriding priority in the allocation of resources, this can be accomplished in a number of ways, but we can be sure that it would not be accomplished by the general expansion of bank credit and money.

I think that is a fine statement. I certainly agree that you cannot build schools by printing money but let us examine how this works out in practice.

It is a fact, is it not, as stated in the President's report, that consumer credit is at an alltime high, and that the overall increase in consumer credit outstanding also set a record in this past year? That is set forth on page 19 of the Economic Report, and I assume it is right.

Mr. MARTIN. That is correct. It went up $6½ billion, Mr. Reuss, in 1959.

There is one interesting thing there. This afternoon we are putting out the figures for December where it increased $270 million in December, which is the lowest increase for some time.

Representative REUSS. It is at what now?

Mr. MARTIN. $52 billion.

Representative REUSS. If controls over the amount of the downpayment and over the length of the term were instituted, this would, of course, cut down the amount of consumer credit outstanding, would it not?

Mr. MARTIN. In my judgment, it would cut it down. How much you cannot precisely tell.

Representative REUSS. The amount of consumer credit thus reduced would then be an available supply of capital for other credit uses, would it not?

Mr. MARTIN. That is correct.

Representative REUSS. And it would thus tend to reduce interest rates for other purposes, would it not?

Mr. MARTIN. There would be a tendency in that direction, other things remaining equal. There would be that much more available.

Representative REUSS. Thus, to stick to your analysis here, if the Federal Reserve instituted controls over consumer credit, to the extent that those controls were effective, interest rates would go down, and school districts could build more schools more cheaply, could they not?

Mr. MARTIN. Other things equal, there would be that much more credit available for other purposes, correct.

Representative REUSS. Your answer was "Yes"?

Mr. MARTIN. Yes.

Representative REUSS. The President's Economic Report also shows that the amount of stock market credit outstanding is also at a very high level, and that currently it is around $4½ billion. I think that is about right. It is still possible under your regulations to borrow for the acquisition of equities on the stock exchange up to 10 percent of the value of those equities, is it not?

Mr. MARTIN. Right.

Representative REUSS. If you instituted a 100-percent margin requirement, that would tend to release for other credit uses the amount of credit which is now going into stock market credit, would it not?

Mr. MARTIN. Yes.

Representative REUSS. That would tend to lower the general interest rate, and thus make it easier for school districts to build more schools and pay less for them.

Mr. MARTIN. Well, it would supply more credit that could be used in other directions. Whether it would go to schools or not is a question.

Representative REUSS. Schools being a part of the credit bidding pool, they would presumably get their share of the increased supply of money at the lower interest rate, is that not so?

Mr. MARTIN. Correct.

Representative REUSS. Then you would agree with the point that I am obviously trying to make, that there are more ways than printing phony money, which none of us want to do, to get some sense of social priority if the Government of this country decided that it was more important to have schools, let us say, than higher tailfins on motorcars or that it was more important to have schools, let us say, than a stock market level of the height of the present market?

Mr. MARTIN. Yes. Another way to get out of it is to raise taxes.

Representative REUSS. Exactly, or better still, plug the kind of loopholes that we have been talking about. That would increase the revenues, would it not?

Mr. MARTIN. That is right. Direct controls of one sort or another can unquestionably be invoked or enacted at one time or another. You may have different views as to how effective they would be or how they would work, but they certainly can be invoked.

Representative REUSS. Then you completely agree with the point I am making, that the Government may express its sense of social priorities between schools and growth producing capital equipment on the one hand, and consumer goods on the other hand, and stock market levels on the other hand, by what it does in the field of fiscal and monetary policy?

Mr. MARTIN. Well, there is no question of it. In the case of stock market credit, it has already expressed itself.

Representative REUSS. Up to 90 percent.

Mr. MARTIN. We now have 90 percent margins.

Representative REUSS. Margins have been at 100 percent in the past, have they not?

Mr. MARTIN. Once or twice. I think it is very doubtful, however, whether the intention of Congress was to completely exclude the stock market from any use of credit.

Representative REUSS. Let me get back to the question that you were discussing with the chairman.

If the Federal Reserve Board, in its wisdom, decides that the money supply should be increased, I believe it is your testimony that either method, the method of lowering reserve requirements or the method of purchasing U.S. securities is mathematically identical?

Mr. MARTIN. That is correct.

Representative REUSS. I am sure you would agree with me that the mere fact that a given method of increasing the money supply gives a break to the taxpayers and returns money to the Treasury is not in and of itself a reason not to adopt that method?

Mr. MARTIN. I certainly agree with that, but I think it would be very dangerous to adopt a policy of making money for the Govern-

ment if, for example, we were facing a recession and what we wanted to do is to get money to work quickly.

Representative REUSS. May I stop you, because I want to get to that and I want to give you a full opportunity to answer.

The method of increasing the money supply by open market purchases rather than by lowering reserve requirements is the method that is good for the taxpayers, is it not? It makes money for the taxpayers and unless there is a countervailing situation, which we will get to in just a second, that is the method which we would want to use, is it not?

Mr. MARTIN. This benefit to the taxpayer is a dubious benefit, in my judgment. I have never advocated policy in terms of giving the banks more earnings.

Representative REUSS. I have not said anything about the banks and earnings.

Mr. MARTIN. But that is an important part of this issue because the banks are taxpayers, also. Their earnings are affected in one sense or another, but what we want to do is put this credit out through the banking system. We do not want the Government running the banking system of the country. We have not decided that the way to manipulate credit is for the Government to do all of the credit extension. That is not what our objective is.

Representative REUSS. What we started with was the proposition that whether you use the open market method or the lower reserve requirement method, a decision having been made to increase the money supply on other grounds, is mathematically identical, but you have said there is a set of circumstances in which it is better to use the method of lowering bank reserve requirements. I think you have suggested that that set of circumstances is the case of a depression or recession, is that correct?

Mr. MARTIN. That is one set of circumstances.

Representative REUSS. Let us exhaust that before we go on to other sets of circumstances.

Mr. MARTIN. All right.

Representative REUSS. I take it the reason that you set up set of circumstances A, the depression-recession set of circumstances, is because of your belief that you need in such a set of circumstances to get money out in a great hurry and that you could not do it fast enough by buying securities on the open market.

Mr. MARTIN. That has been demonstrated to my satisfaction.

Representative REUSS. That is your reason, is it not?

Mr. MARTIN. That is right.

Representative REUSS. All right.

Now let us go on to set of circumstances Nos. 2, 3, 4, or however many you have. What is the next set of circumstances where you feel that mathematics must be thrust to one side and where there are countervailing practical considerations?

Mr. MARTIN. I think you have to judge the market at any particular time. You have this matter of announcing the expectations or the psychology of a market which is what we have to deal with all the time when you announce the reserve requirement. You have to announce it in advance as of a certain date.

Representative REUSS. That is a reason against using the reserve requirement method. What I was asking you, was what are reasons against using the open market method?

Mr. MARTIN. Mr. Reuss, in the last few years we have used open market operations in total about half and half with reserve requirements.

Representative REUSS. That is fine. What I am asking, though, is this question. If the open market method by and large is the method that is good for the taxpayers, because it results in the Federal Reserve getting the income from those bonds which is then channeled through to the Treasury, if that is true of open market purchases, should we not then adopt a working principle of using open market purchases as the royal road in this day and age except where there are countervailing considerations? Now, you named countervailing consideration No. 1, where you have a depression, and I say fine. We will put that to one side. Is there anything else, though?

Mr. MARTIN. There is gold inflow and outflow.

You might want to adjust. Certainly an increase in reserve requirement is the best way to mop up a large gold inflow.

Representative REUSS. Why not go out and buy in the open market?

Mr. MARTIN. In this instance, one would be selling, not buying. However, one must keep in mind that the market process is a very important thing to the structure of confidence in the dollar. The more our methods of regulation impinge on the market process, the more we undermine as time goes on the confidence that comes out of market forces with regard to the dollar or, for that matter, any currency.

Now, you can carry this thing to the extreme of using the Federal Reserve to make money for the taxpayer and you will gradually work yourself into a position where, as I have said, you are defeating the general public interest, and, as a minimum are certainly undermining our private enterprise system. I am not saying we are in any danger of that in the foreseeable future, but the ultimate is that you will have the entire banking system being run to make profits for the Government and run by the Government.

Representative REUSS. All we are talking about is the foreseeable future and, since the foreseeable accretions to the money supply involve only a relatively modest set of purchases by the Federal Reserve, moderate in relationship to the total supply of outstanding Government securities, I do not think that talking about the unforeseeable future is really important.

Mr. MARTIN. I am just trying to point out that we have been using open market operations very generously and accurately.

Representative REUSS. Did you not use it last December in the vault cash matter, which I want to discuss?

Mr. MARTIN. We used it along with that. It was used quite actively during the period, Mr. Reuss. I would be glad to return to the vault cash and discuss that with you. Vault cash has not been counted in reserves since about 1920, I guess, in this country. It has not even been a part of the thinking of banks. We have a great deal to learn about administering vault cash as reserves. We were not certain in December whether we were supplying reserves or not.

Representative REUSS. I want to talk about the $270 million you put into reserves when my next go around comes.

Representative PATMAN (presiding). Have you finished?
Representative REUSS. Yes.
Representative PATMAN. Mr. Martin, I again want to assure you that I do not mean anything personal in our discussion. I know our arguments at times get heated in view of our fundamental differences of opinion but I always credit you with being honest and sincere in your views and convictions and I certainly feel that you have no ulterior motives.
Mr. MARTIN. Thank you, Mr. Patman.
The CHAIRMAN. First, let me say that I regret that you still hold to the views that you held last summer that increases in the money supply should in the main be obtained by lowering reserve ratios rather than by open-market operations.
Mr. MARTIN. I have never said that.
The CHAIRMAN. I think you have.
Mr. MARTIN. No, I have said that there are real reasons why we should have lower reserve requirements ultimately and I have also indicated that this is a matter of judgment which is the really essential point here. It is a matter of judgment. If you were on the Federal Reserve Board, you might operate differently than we are operating, any one of us.
The CHAIRMAN. But your judgment does not coincide with ours.
Mr. MARTIN. I am certainly doing my best to benefit by your judgment.
The CHAIRMAN. This will have to be argued out in the court of public opinion. I would like, however, to raise this point: Do you still hold to the doctrine that such dealings as you carry out in Federal securities should be confined, except on very rare occasions, to bills of 91-day issues?
Mr. MARTIN. It has been my contention right along, Senator, that a central bank should operate for the most part in the short end of the market.
The CHAIRMAN. Almost exclusively?
Mr. MARTIN. I think as far as it possibly can. I think it is better operating procedure.
The CHAIRMAN. I would like to hear why you hold this point of view.
Mr. MARTIN. I will tell you one of the practical things involved is that—you have been up to New York and visited the desk. You are familiar with the techniques that are involved and I am very jealous and zealous in guarding the integrity of the desk at the Federal Reserve Bank of New York. We deal with a great many customers through that instrument in the purchase and sale of securities. These people are situated in a great many areas of the country, some of them in San Francisco, some of them in New York, and some elsewhere. I would like to minimize any chance—this is quite aside from the broad philosophical point, any chance that some buyers or sellers in the market, variously situated in the country, will charge our trading desk with favoritism to one customer group or another.
The CHAIRMAN. May I ask why this would be more possible if you purchased or sold longtime securities than if you did not?
Mr. MARTIN. Because of the fluctuations themselves. There is more likely to be wider price fluctuations and wider spreads between bid and ask prices in long-term securities than in the short-term securities.

If you are dealing in a 91-day bill, it is just a matter of the time until the bill runs out. Because it provides a store of value for temporarily available funds, many investors are interested in its ownership and market trading in it will be both active and continuous. You are not going to have the same price fluctuation or trading spread in that kind of instrument that you have in the 30-year bond.

The CHAIRMAN. Is this a primary reason?

Mr. MARTIN. No, this is one of the important reasons, though, from a practical operating standpoint.

The CHAIRMAN. Are there any other reasons?

Mr. MARTIN. My impression is that central banks the world over—certainly practically everybody I have discussed the subject with—think that, in view of the role of the central bank, it should continuously have as liquid a portfolio as possible.

The CHAIRMAN. I am talking of bonds. Even though they run for 30 years they are liquid. You can always dispose of them. There is always a market. Is it not about as liquid a market as you can get?

Mr. MARTIN. This is a matter of judgment, again, but I say it is much easier to buy than it is to sell in the long-term market. I have been through it a number of times and the experience always is that you accumulate long-term securities and that when you want to sell, as we would have been doing in the recent period on a number of occasions, you find it difficult to do. In the bill market, you can readily get buy offers with small shadings in price and, if you don't, you can let the bills run off. The point is you will never disrupt the market at the short end with your operations.

Now, there is no reason at all to say our policy of buying and selling short-term securities is inflexible. We have said that that is a general policy and that we would make some exceptions. We may make such exceptions at any time.

The CHAIRMAN. I think those have been on three occasions.

Mr. MARTIN. There have been relatively few that are and I have seen very little reason why from an operating standpoint we should have made any others.

The CHAIRMAN. In times past, you have sometimes justified this by saying that it is, (*a*) proper to affect the short-time rate of interest but not to affect directly the long-term rate of interest.

Is this one of your reasons now? Is it proper to affect the short run but not the long run?

Mr. MARTIN. I have testified on several occasions here that I can see more advantage in time of recession in our dealing in the long end of the market than I can in time of restraint. If you want it to affect directly in time of recession the interest rate on long-term bonds, I can see more point under those conditions.

The CHAIRMAN. That is buying long-term bonds in times of recession?

Mr. MARTIN. In times of recession it might contribute.

The CHAIRMAN. Purchase of long-time bonds during recession would raise the price and lower the yield and hence lower the interest rate and raise investment.

Mr. MARTIN. Right.

The CHAIRMAN. Thank you. This is what we have been arguing for for some time and I appreciate the corroboration which you have given to our position.

Mr. MARTIN. I am afraid you are overstating it.

The CHAIRMAN. I am delighted that we are at least affecting the citadel.

Mr. MARTIN. I regret to say that I have made this statement on a number of occasions up here in the past and I have pointed this out. I say that it is more likely to be valuable at that time than at another time, but I have some question about the wisdom of it even under those circumstances and there, I think, it is a matter of judgment for the monetary authorities that they should exercise their best judgment that they can on what will be the most effective for general montary policies.

The CHAIRMAN. Do you think that the staff of the New York Federal Reserve bank consists of competent experts? Do you regard them as competent?

Mr. MARTIN. I do.

The CHAIRMAN. Is it not their position that you should abandon the bills-only policy and instead deal in long-term bonds?

Mr. MARTIN. I have not the New York bank here.

The CHAIRMAN. Are their views unknown to you?

Mr. MARTIN. Not in the slightest.

The CHAIRMAN. Are not their views what I have stated?

Mr. MARTIN. No, I would say that, generally speaking, the New York bank thinks that we ought to operate in the short end of the market.

The CHAIRMAN. In other words, they are advocates of bills only?

Mr. MARTIN. They are advocates in a general way that under most conditions—and you can send for Mr. Hayes or anyone else you want from the New York bank, and under most conditions I think they would agree that we have been operating in the right way.

The CHAIRMAN. I guess language does not mean anything. I read the exchange of correspondence between you and Mr. Sproule some years ago.

Mr. Sproule was certainly advocating a much greater use of the long-term market than short term.

Mr. MARTIN. I cannot speak for Mr. Sproule, but I do not think that it is Mr. Sproule's belief that we should be what I call dabbling wholesale in the long-term end of the market. I just do not think so. I may be wrong.

The CHAIRMAN. You use question-making terms. The point is more or less—I have always understood the New York bank to think that you should deal more in long-term securities than you are doing.

Mr. MARTIN. That may be true.

The CHAIRMAN. Is it true?

Mr. MARTIN. They attend every open-market meeting.

The CHAIRMAN. I am asking you a straight question: Does the New York bank think the Reserve should be trading more in long-term securities than it has been doing?

Mr. MARTIN. I can only say that we have had an open-market meeting every 3 weeks and the New York bank has not made an effort to get us to buy more long-term securities at any time in the last 6 months.

The CHAIRMAN. Is that not largely because they know that you would not permit them to do it and that you have got a majority in the open-market committee?

Mr. MARTIN. They still can speak their piece.

The CHAIRMAN. They can speak their piece but they cannot carry out the policy.

Mr. Martin, what is the use of having this verbal fencing back and forth?

Mr. MARTIN. I say the same to you in a perfectly good-natured way because we have not got the New York bank here today.

The CHAIRMAN. Is it not true that the New York bank believes that you should trade to a greater degree in long-term securities?

Mr. MARTIN. Let us ask the New York bank to write a memorandum.

The CHAIRMAN. I am asking you, Mr. Martin. I have a right to ask this of you.

Mr. MARTIN. I say to you that I do not know. That is the only answer I can give.

The CHAIRMAN. You do not know.

Mr. MARTIN. I do not know what the New York bank's position is on whether we are buying too little or too less.

The CHAIRMAN. Mr. Martin, I am shocked at this. For the first time, I am really shocked that on such an important matter as this you say that you do not know the attitude of the New York bank. It is with great sorrow and inner pain that I say that I am shocked but I am shocked.

Mr. MARTIN. I am sorry that you are bleeding so, Senator.

The CHAIRMAN. Do you know whether they agree with you?

Mr. MARTIN. They do not agree with me. Everybody in the System does not agree with me on everything. The System would not be worth anything if everybody agreed with me.

The CHAIRMAN. On this point of bills only.

Mr. MARTIN. I would say that there has been no question that the overwhelming majority in the System have agreed with the policy we have been following.

The CHAIRMAN. Now, sir, I do not think it is profitable to pursue this any further except that I ask that the record stand as it was stated and that no alterations be made in the record at this point.

Representative CURTIS. Does the Senator want to make that for the entire record?

The CHAIRMAN. No, for this particular point. There will be no changes made in the record at this point.

Representative CURTIS. I think if we are going to change the rules of the committee——

The CHAIRMAN. I mean on the accuracy of the statement.

Representative CURTIS. We have a problem here, Senator. We are not changing the committee rules like that. I do not know whether the stenographer is going to make mistakes or not. I assume that you will want to look at your remarks. The implication is that somebody will change the meaning and I think that we properly will resent. If the Senator thinks he made a point, well enough. That is all you are trying to say. Let it rest.

The CHAIRMAN. I simply say that I think this record as made in the last few minutes should stand.

Representative CURTIS. All I am saying is that I think any record made should stand but we have found over many years that the best

way to do it is to allow the people engaged in a colloquy to correct stenographic errors and make clear what they might not have made clear.

The CHAIRMAN. Now, the next question I would like to raise is about the lack of regulation of the Government securities market in New York. Am I correct in believing that in practice virtually no margin is required of customers who purchase bonds from the 17 security dealers, that they operate in the main without margins?

Mr. MARTIN. The dealers themselves buy and sell for cash; they do not maintain margin account facilities for customers. Government securities may be bought on margin account through many stock exchange houses; otherwise, such credit purchases of Government securities would largely be arranged through commercial banks.

The CHAIRMAN. I think there are 5 of the 17 who are members of the stock exchange. The other 12 are not members of the stock exchange and are therefore not subject to the stock exchange requirement, is that not true?

Mr. MARTIN. That is correct.

The CHAIRMAN. With virtually no margins required?

Mr. MARTIN. They operate on a cash basis; they do not provide a margin service to customers. However, credit financing of Government securities is usually effected with small margins. The dealers' own borrowings are accomplished with small margins.

The CHAIRMAN. Almost none.

Mr. MARTIN. I would not say almost none.

The CHAIRMAN. I think that is true. On the short term I think there are no margins at all and for the long term perhaps 1 percent.

Now, did not this lead in 1958 to a very bad situation in the Government securities market in New York?

Mr. MARTIN. You will recall, Senator, that we gave you quite an exhaustive study on this.

The CHAIRMAN. Yes.

Mr. MARTIN. And Mr. Young is with me. We are continuing to work on it. You recently paid tribute to the new statistical accounting.

The CHAIRMAN. Which we suggested.

Mr. MARTIN. And we are very glad to have your approbation of our carrying through.

The CHAIRMAN. I understand. It is a question of policy and what I am feeling at is this. Should not margins be required on the purchase of Government securities just as are now required on the purchase of stocks.

Mr. MARTIN. We are making a study of that now with the Treasury and we have not come to a conclusion.

The CHAIRMAN. It has been a year and a half since this happened. You made a three volume study. How much longer before you are going to make up your mind?

Mr. MARTIN. I am inclined to think that some margins ought to be required, but we have not arrived at a decision on this.

The CHAIRMAN. That is, you think that some margins should be required?

Mr. MARTIN. Yes, indeed; I do.

The CHAIRMAN. That is what the majority of this committee believes, too, and that is what we recommended. Perhaps we will be able to work together on this and we will be interested in the actual degree to which you carry those policies out. The absence of margins can lead to undue speculation in Government securities, is that right?

Mr. MARTIN. It can.

The CHAIRMAN. And when Government securities declined in price during the summer of 1958, did not this lead to the forced selling of securities by speculators and did not this forced selling cause a still further fall in the price of Government securities and did not this damage the credit of the United States so far as European countries and bank authorities were concerned?

Mr. MARTIN. 1958 experience was an unfortunate one and unquestionably there was too much speculation in Government securities.

The CHAIRMAN. And this speculation had been stimulated in part by the absence of margins?

Mr. MARTIN. That was one of the factors, Senator; yes, sir.

The CHAIRMAN. And the imposition of margins would have diminished the speculation and contributed a greater steadiness in the price of Government bonds and less damage to the public credit at least so far as foreign governments are concerned?

Mr. MARTIN. Yes. Let me point out, Senator, that there is no legal authority for such margin regulation.

The CHAIRMAN. Have you asked for that authority?

Mr. MARTIN. We have not asked for it yet.

The CHAIRMAN. Let me say that if you do ask for that authority, I, for one, and I think the majority and members of my party would loyally support you in this. We hope very much that you will give us a lead and help us out.

Representative CURTIS. Will the gentleman yield?

The CHAIRMAN. Surely.

Representative CURTIS. Why does the gentleman make a political issue out of it without consulting the minority? Maybe we might agree.

The CHAIRMAN. It is in our report. I am not sure of the position that the minority took.

Representative CURTIS. You were speaking of your party.

The CHAIRMAN. I spoke for my party because I could not speak for yours.

Representative CURTIS. I doubt if you can speak for your own.

The CHAIRMAN. I hope that you will back us up on this and help transform this from a political issue.

Representative CURTIS. I think that we should first examine what the issues are and then find out whether there is a political difference. You propose it the other way. I appreciate you need political issues.

The CHAIRMAN. I notice that when any measure on behalf of the public is suggested, the gentleman from Missouri and his party colleagues immediately declare it to be political.

Representative CURTIS. I want to say this: Any time that you try to make a political speech here on the Joint Economic Committee, yes, I try to get it back on economics. That is not to say that there is not plenty of room for political disagreement and we should have it, but let us state it fairly.

The CHAIRMAN. May I say that I was attempting to find out whether margins should or should not be imposed in the purchase of Government bonds.

Representative CURTIS. That was very interesting.

The CHAIRMAN. There was nothing political in it at all. I simply said that if the Chairman and the Board would propose this that he would find a good deal of support.

If this is politics, you will just have to make the most of it, and I hope you will play politics on a similar high level.

Representative CURTIS. Let us put it this way. I think the gentleman was doing very well until he reached the point where he tried to leave the impression that maybe his party was the saint and my party was the sinner.

The CHAIRMAN. We will gladly share what sainthood we have with you. You need it very much. We will pass it around.

Then when can we expect some recommendations on this question of margins on the purchase of Government securities?

Mr. MARTIN. I have learned from long experience not to specify any precise time on such a technical subject.

The CHAIRMAN. Can you make a recommendation in 1 month?

Mr. MARTIN. No; I would not want to say.

The CHAIRMAN. Could we give you 2 months?

Mr. MARTIN. No; I would not pick any time.

The CHAIRMAN. Three months?

Mr. MARTIN. No, sir.

The CHAIRMAN. Four months?

Mr. MARTIN. We will do it. We might do it in a week. We might do it in a year.

The CHAIRMAN. Can we look for this in 2 months?

Mr. MARTIN. I make no promises.

The CHAIRMAN. You see, we are going to adjourn around the Fourth of July, so please make your recommendations in time for us to act. Do not resort to the old army game of stalling. At times we have suspected that the studies of the Federal Reserve Board are sort of elastic in their findings and have frequently been prolonged to avoid action.

Will you speed up your study of recommendations, Mr. Martin?

Mr. MARTIN. This Government securities market study has been pursued by Mr. Young on my right, who is Secretary of the Open Market Committee now, as vigorously and accurately as we can pursue it.

The CHAIRMAN. May we expect recommendations in the next month?

Mr. MARTIN. I cannot promise.

The CHAIRMAN. You know by failing to make recommendations, by failing to make decisions, you really make decisions. By failing to make recommendations for the imposition of margins you are making decisions not to impose margins. This is very important.

Mr. MARTIN. That is a valid point and one that we are very aware of.

The CHAIRMAN. What about other regulations in the market? Are you thinking of regulating the market in other respects?

Mr. MARTIN. Well, we have had under discussion for a long time a great many aspects of this. We have had a good many problems to work out within the system on this. You must remember I have 19

men, 6 Board members in addition to myself and 12 presidents, and I have to consult all of them.

The CHAIRMAN. Do you exercise a good deal of control over those members, Mr. Martin?

Mr. MARTIN. Well, control is a very strong word. I do the best I can to lead them when I think I am right, as you try to lead your committee here.

The CHAIRMAN. You do not have the minority that I have. You have really sort of a regimented group. I think I have taken up my time.

Congressman Patman, you are next.

Representative PATMAN. I will start where I left off, Mr. Martin. We were discussing the table on the gross national product and the percentage of the money supply as compared to the gross national product, in which I call your attention to the fact that it has been reduced very much in the last few years.

In 1954, the money supply was equal to 35.2 percent of the gross national product. Since that time it has been reduced almost steadily. There was a slight interruption in 1958 but last year, 1959, the money supply was down to 29.3 percent of the gross national product.

Would you agree that your holding down the growth of the money supply at the time when the economy was increasing and there was an increased demand for money has been the principal cause for the increase in interest rates?

Mr. MARTIN. No, but I think it has been one of the factors in the increase of interest rates.

As I tried to point out at some length in the first part of my statement today, the credit expansion in 1959 is really a spectacular one of course, credit has increased most years but here is a $60 billion increase. I am please that most of that has not come about through an increase of bank credit. We have to look at the flow of savings and we have to look at the methods by which we can induce people to save and to invest.

I used to attend Wesley Mitchell's classes at Columbia and he used to constantly say to us that the per capita real income in this country has gone up almost in direct proportion to private investment in plant and equipment facilities and new technology and new skills and I still think that that is true. He has been dead for a number of years, but I think that recent years have demonstrated that to be the case.

Representative PATMAN. I will turn to another subject.

Business Week for January 30, in the article from which I read an excerpt says:

> Martin says that since they are responsible to Congress which has constitutional authority to regulate the money supply Fed will conform to its wishes.

Would you, agree, Mr. Martin, that the only authority for issuing money and regulating the value of money is in the constitutional authority to Congress.

Mr. MARTIN. I have never challenged the authority of Congress.

Representative PATMAN. Would you agree that the Federal Reserve is operating on a delegation of the power of Congress to create money to its value?

Mr. MARTIN. The Federal Reserve Act is our trust indenture as I constantly describe it.

Representative PATMAN. You have always insisted, I believe, or at least your predecessors have, that the Federal Reserve Act is different from other acts of Congress in that it set up an independent agency that is responsible only to the Congress in regulating money. Is that your view of it?

Mr. MARTIN. I have never tried to establish that the Federal Reserve System is outside of the Government of the United States. The emphasis that I have tried to place on it is that it was given independence within the Government with the primary responsibility for safeguarding to the best of its ability the integrity of the currency and for managing the money.

Representative PATMAN. I have read the Federal Reserve Act and I have read the discussions leading up to the enactment of the law and I cannot follow some of these people who say that it is a peculiar kind of bill or law that sets up an agency that is in a different status from other agencies. The way I view it is that the Federal Reserve Act is law, passed by Congress and signed by the President, just like any other law. That is the reason I cannot understand how President Eisenhower could say that the Federal Reserve is "independent" when the Constitution of the United States says, in article III, in outlining the responsibilities and duties of the Chief Executive, the President, uses language to the effect that he shall take care that the laws be faithfully executed. I cannot understand how he can say that this agency is outside of that responsibility.

Can you give me a little enlightenment as to how the Federal Reserve System is outside of the President's responsibility to see that that the laws are faithfully executed?

Mr. MARTIN. The Federal Reserve Act, I think, speaks for itself, Mr. Patman.

Representative PATMAN. It does not say anything like that, though.

Mr. MARTIN. It does not spell it out that way, but I think if you will look at the history of the Federal Reserve Act, you will see it is independence within the Government that is involved and it has a special responsibility for the management of the currency of the United States.

Representative PATMAN. As an agency of Congress. Of course, that is the only way it could get it.

Mr. MARTIN. And the Congress, as I repeatedly testify, can rewrite or change the Federal Reserve Act any time it wants.

Representative PATMAN. If someone were to ask you the question: Who owns the Federal Reserve banks? What would be your answer?

Mr. MARTIN. Mr. Patman, we have been over this many times. The Federal Reserve System was a unique political contribution in my judgment by Woodrow Wilson in his administration. Senator Glass took a part in it. It provided for a merger of public and private interest to safeguard the currency. The Federal Reserve Board in Washington is clearly Government. The Federal Reserve banks are quasi-government, or quasi-private, depending on where you want the emphasis.

I have repeated this a great many times.

A distinguished professor in Oxford University, when I was attending some lectures there a good many years ago, said that, in his judgment, the United States had only made two real contributions

in political science. One was the Northwest Ordinance. I will not go into his reasons for that. The other was the Federal Reserve Act because in the Federal Reserve Act you had a merger of public and private interest without nationalizing the bank system but bringing the currency into consonance with the public interest through the Government.

There is certainly no question at all that if we want to review the entire institutional framework of the Federal Reserve System we can do it any time we want. You certainly have taken the lead in raising points on it. I remember discussing this at great length with you in 1952 when you were chairman of a committee that worked on this, and I do not think there has been any change in substance in this institutional relationship since that time.

The way the banks participate in the Federal Reserve System is that we have accounting procedures that are in accord with business practice and we have participation that is in accord with business practice. The way that it is arrived at is that the member bank becomes a part of the system. Banks do not have to be members except that all national banks have to be members. If a bank is a national bank it must subscribe up to 6 percent of its capital and surplus to stock of a Federal Reserve Bank; other banks who choose to be member banks are subject to a similar statutory requirement.

Representative PATMAN. Mr. Martin, as you said, we have gone over that a lot. For the sake of brevity, may I ask you this question on which I think we will both agree. The commercial member banks in the Federal Reserve System do not own a proprietary interest in the Federal Reserve System?

Mr. MARTIN. I have testified to that many times.

Representative PATMAN. That is correct, is it not?

Mr. MARTIN. They do not have a proprietary interest.

Representative PATMAN. And you cannot have ownership unless you have a proprietary interest. That is correct, too, is it not?

Mr. MARTIN. They have a sense of participation in it.

Representative PATMAN. I am not disputing that. I am talking about proprietorship now.

Mr. MARTIN. On proprietorship, you and I have agreed repeatedly.

Representative PATMAN. My theory, and I do not think that anyone would dispute it, is that you cannot have ownership unless you have a proprietary interest.

I have a letter of January 18 from the American Enterprise Association which, of course, is a prominent business organization engaged in educating the public and making public opinions and attitudes on many subjects. It is addressed to Congressman Oliver of Maine. It reads in part:

> Thus, as you can see, technically speaking the 12 Federal Reserve banks and their branches are owned by the private commercial banks in each Federal Reserve district where a Federal Reserve bank is located, but the Federal Reserve System is a quasi-governmental operation since the Board of Governors which determines overall policy is appointed by the President and this Board in turn appoints one-third of the directors of each Federal Reserve bank. Furthermore, excess earnings of the System are paid into the Federal Treasury.

Do you agree that the Federal Reserve banks are technically owned by the private banks, Mr. Martin? You cannot do that and say that they have no proprietary interest, naturally.

Mr. MARTIN. No, I do not say that. I say there is a blend of private and public interests.

Representative PATMAN. If the private commercial banks own the Federal Reserve banks they would own also, would they not, the Government's power to create money?

Mr. MARTIN. They would have a different relationship to the Federal Reserve System than they have today.

Representative PATMAN. Would you care to engage in some public education and public enlightenment by informing the American Enterprise Association that the private banks do not own the 12 Federal Reserve banks, either technically or otherwise?

Perhaps I will not ask you to take on that chore specifically because I know that they probably have all the information that we have, and they will certainly see this record. I hope that will be sufficient information to them to let them know that it is incorrect.

Now, the Fed is given credit for bringing the Treasury's budget into balance this year by the payment of $266 million from its surplus funds. When did you make that payment into the Treasury, Mr. Martin? Was it before the end of the year, or after the end of the year?

Mr. MARTIN. It was made on the books of the Federal Reserve on December 31 and did not get into the Treasury until a few days later.

Representative PATMAN. That brings me to another point that I want the chairman and the members of this committee to listen to, if you please.

Under the law, the Federal Reserve Board makes a report annually. Now, of course, the law contemplates that the report would be made in time to be of help to the Congress. Over the years I have noticed that these reports are coming later and later. Last year covering the operations for 1958, it was late July before we got it.

I have been following this thing for a long time and I remember that the System used to issue a preliminary report within a few days after the first of January showing the principal things, and would issue its other report in, say, 30 or 60 days or possibly 90. However, we would always get the report before the Congress was nearly over. With this practice which you have been pursuing in the last few years, if I am correct in the belief that you have been waiting for 6, 7, 8, and 9 months to file your report, it is of little immediate value to the Congress because they are ready to adjourn. The object of that report, as I construe it, is to give us information about actions and matters which you do not publish monthly in the Federal Reserve bulletins, but which you are obligated to give us soon after the first of each year. Why did you delay so long last year, Mr. Martin, in filing that report with Congress?

Mr. MARTIN. It was far too long and I will make a commitment to you that we will get the report here much more promptly this year.

Representative PATMAN. How soon will you have it out?

Mr. MARTIN. I think we will have it out before April 1.

Representative PATMAN. I am surely glad to hear that. You could not make it March 1, could you?

Mr. MARTIN. We will try to split it in the middle.

Representative PATMAN. Listen, Mr. Martin. You know you have that information and can put it together in 2 hours because you prepared it for your Federal Reserve bulletin and for all these reports.

Mr. MARTIN. I am not trying to be facetious.

Representative PATMAN. I cannot afford to argue with you.

Mr. MARTIN. I am not trying to be facetious. How long did it take to put together your majority and minority report? You do not sit down and just write these things out.

Representative PATMAN. We have differences of opinion. You do not at least at the time of the report. Votes have already been recorded. All you have to do is tell us what the vote was on an Open Market Committee action, for instance, and yet you are not giving us that for months and months the fact—when it is almost too late to be of any use to us.

Mr. MARTIN. I have apologized for last year. I am sorry that took so long.

Representative PATMAN. We need a record on this. Suppose you have the record compiled since this Federal Reserve System was organized and give us the dates of the annual reports each year. Would you do that, please?

Mr. MARTIN. I will be very glad to do that.

Representative PATMAN. Also, put in there the preliminary reports, and when they were issued, and the time of the year, and why you have discontinued them.

Mr. MARTIN. I do not know about these preliminary reports, but I will look into them.

Representative PATMAN. I am asking you to insert that for the record.

(The information follows:)

Since the first report in 1915, the Board's Annual Report has been transmitted to Congress on the following dates (asterisk indicates date of report, date of actual transmittal not being available):

1914—Jan. 15, 1915*
1915—Feb. 14, 1916
1916—Feb. 3, 1917*
1917—Jan. 22, 1918
1918—Feb. 8, 1919.
1919—Feb. 23, 1920
1920—Feb. 16, 1921*
1921—Feb. 20, 1922
1922—Feb. 28, 1923
1923—Mar. 29, 1924
1924—Feb. 28, 1925
1925—Apr. 10, 1926
1926—Mar. 2, 1927
1927—Mar. 26, 1928
1928—Mar. 1, 1929
1929—Apr. 24, 1930
1930—Mar. 4, 1931
1931—June 17, 1932
1932—May 19, 1933
1933—June 11, 1934
1934—July 2, 1935
1935—May 15, 1936
1936—June 23, 1937
1937—Apr. 4, 1938
1938—Jan. 31, 1939
1939—Apr. 19, 1940
1940—July 3, 1941
1941—May 28, 1942
1942—Apr. 12, 1943
1943—May 1, 1944
1944—May 11, 1945
1945—June 14, 1946
1946—July 7, 1947
1947—May 6, 1948
1948—Aug. 11, 1949
1949—Aug. 14, 1950
1950—June 14, 1951
1951—Aug. 28, 1952
1952—May 28, 1953
1953—Mar. 4, 1954
1954—Mar. 15, 1955
1955—Apr. 6, 1956
1956—June 12, 1957
1957—Apr. 21, 1958
1958—July 23, 1959
1959—Mar. 10, 1960

We are unable to identify the preliminary report referred to by Mr. Patman with any specific document, unless the reference is to the report on the "Earnings and Expenses of the Federal Reserve Banks" which is made available at the end of February each year. There has been no change in this schedule.

Representative PATMAN. Do you have the December 1959 Federal Reserve Bulletin there? Look and see how many political subdivision bonds are owned by the commercial banks. It is about $16 million.

Mr. YOUNG. Yes.

Representative PATMAN. That is about 30 percent of all the outstanding political subdivision tax-exempt bonds in the Nation. If you have any trouble finding the page, I would not want to delay the proceedings too long. It is in the right-hand column.

Mr. YOUNG. I am not sure to which page you are referring.

Representative PATMAN. Now, do you have the January 1960 Bulletin? Where are the data on the amount that the banks hold of the political subdivisions' securities?

In the December 1959 report, it is reported that $16.5 billion of the political subdivision bonds were held by all the commercial banks, and the report elsewhere gives the total amount of tax-exempt bonds so the commercial banks had about 30 percent of the total.

Now, in the January 1960 issue of the Federal Reserve Bulletin, that column has been dropped. That information has been dropped and it has been merged with other securities, if I am correct about that, and that is the way it looks to me. I hope you reestablish the December list which gives the amount of political subdivision bonds held by the commercial banking system as distinguished from U.S. Government bonds and other securities. Am I correct in that?

Mr. YOUNG. Yes, that was dropped to make room for some other items. It is in the call report.

Representative PATMAN. That is a very important column. In other words, it deals with commercial banks.

I am not against the commercial banks; I am for them, and I want them to make money. I want them to be profitable. That is the only way they can serve the people adequately.

I am not against fair profits for commercial banks, but I do not look with favor upon commercial banks creating the money to buy tax-exempt securities. To the extent that they are engaging in that activity, when people have to work awfully hard to pay taxes on what they own or earn in order to pay for those bonds, including the interest, it just does not look right; and I hope that the Federal Reserve will not try to obscure the figures.

I do not say that you intend to do so, but it might appear that way if you persist in merging that information where it could not be detected.

Mr. MARTIN. We certainly have no intention to obscure any information. As you well know from previous information, I am not very happy about tax-exempt securities.

Representative PATMAN. I have one other question.

When you delivered $266 million to the Treasury, you had about $750 million left, did you not?

Mr. MARTIN. Yes.

Representative PATMAN. Why did you not deliver it all? Why did you just deliver $266 million? Why did you not say to the Treasury, "We are not using that money. It is idle and unused. We are not investing it. It serves no purpose"? And I could show that by your own statements. Why did you not give it all over to the Treasury and save the people that much interest?

Mr. MARTIN. You cannot say from statements that I have made that it serves no purpose when this comes to the institutional framework of the Federal Reserve System. If you want to change it so that we don't have any capital, any surplus, we do not have any participation by the banks through stock ownership of securities, you will have an entirely different institutional concept than we have today. The change that we made at the end of the year, which came in part out of hearings that you and I have participated in for some time, we started working on in June and finally decided that we would not, particularly in a period of relatively high interest rates, want to be in the position of keeping from the Treasury anything, so that we now are paying 100 percent. You say we ought to give everything.

Representative PATMAN. That is right.

Mr. MARTIN. I say that you are then basically changing the institutional concept of the System and the business accounting procedures.

Representative PATMAN. Let me quote your exact language on November 21, 1957, when I was interrogating you and I stated,

> Surplus funds are not at present used in the Federal Reserve System corporations,

and other members of the Board, at least three other ones, say that these funds are not needed, are not used, are not invested, serve no purpose.

Mr. MARTIN. No, Mr. Patman. That is not right.

Representative PATMAN. I have the testimony here. I can read it.

Mr. MARTIN. That testimony says at present they are not being used but we have uses in Government securities. We have contingencies to work against and all of this is a part of this institutional concept and also the accounting procedures of the System.

The CHAIRMAN. Congressman Curtis.

Representative CURTIS. In other words, what you are saying is that there is a purpose?

Mr. MARTIN. Of course, there is a purpose.

Representative CURTIS. I only have a few points for my own information.

In the discussion of consumer credit, a great deal of consumer credit has some saving aspect about it, does it not?

Mr. MARTIN. Right.

Representative CURTIS. Is that one reason why you said that you were happy to see a lot of this credit that was not bank credit as recently extended?

Mr. MARTIN. That is correct. In a period like this, we ought to be doing everything in our power to minimize the substitution of bank credit for savings.

Representative CURTIS. I see Mr. Patman has gone.

The CHAIRMAN. For the record, I would say he has gone to answer a rollcall.

Representative CURTIS. Yes; I know he has. He was quoting from Business Week and I forgot to ask him who wrote the article. I do not like this anonymity. He made the remark that Business Week is a Republican organization. I did not know that Business Week thought they were. I can personally vouch for the fact that in that organization there are some people who certainly would not qualify as Republicans. I would be very happy if they all were, but perhaps

I can find out from him. It is an unsigned article. If that was not read out of context—the portion that I heard—I think for the sake of the record we should find out who wrote that article.

I wonder if the staff would find out who wrote this article.

The CHAIRMAN. May I say that I think it is improper for a congressional committee to inquire within a newspaper or a magazine who wrote an article.

Representative CURTIS. I certainly do not, when an article is used as this one has been used.

Now, if people want to hide behind the anonymity, I will still make a request. I will try and find out myself.

The CHAIRMAN. May I say that this is a very proper matter for Mr. Martin to take up, if he wishes, with Business Week.

Representative CURTIS. I make a request as a member of the committee.

Mr. MARTIN. Let me just state, Senator, that I do not try to influence the press in what they write about me or say about me and I do not quarrel with them. They do not always write what I would like them to write. They sometimes say things that I would not agree with, but all I do is try.

The CHAIRMAN. The members of this committee have the same experience.

Representative CURTIS. Oh, yes.

The CHAIRMAN. The chairman has a good deal of this experience currently, but always takes the position that we should have a free press, that people should be entitled to write what they wish, that a congressional committee should not attempt to put the pressure of public opinion upon them, and that, similarly, the executive department should not try to do so.

Representative CURTIS. Then I make the countersuggestion, Mr. Chairman—I think there is a lot in what you say—I make the countersuggestion that perhaps the members of the committee should refrain from using an unsigned magazine article and using it as if it were something other than that. That is all.

The CHAIRMAN. I do not want to keep you here unduly, but my colleague, Mr. Patman, would like to have you still before us, I think, when he returns.

There are some questions that I should like to ask.

There has been some apprehension that with a gold stock of, I believe, $19½ billion in this country and with some $12½ billion held as a 25-percent reserve against Federal Reserve notes and deposits in the Federal Reserve System, this leaves us a free margin of only $7 billion, and that if there should continue to be unfavorable balances of payments or if the Europeans were to withdraw their claims or assert their claims, that there would be a very dangerous exodus of gold.

Do you agree that that is a danger?

Mr. MARTIN. I think that as long as we maintain sound fiscal and monetary policies that the world has confidence in, we do not have to worry about it. I think that is the heart of the problem.

The CHAIRMAN. Can we continue to run a $3 or $3½ billion deficit in balance of payments each year?

Mr. MARTIN. No; I do not think so, Senator.

The CHAIRMAN. How would you correct this?

Mr. MARTIN. Well, I think that we have to be alert to it. We have to try to increase our exports and to be more competitive in world markets.

The CHAIRMAN. Do you have any suggestions as to the foreign policy that we should follow?

Mr. MARTIN. I believe in a liberal foreign trade policy.

The CHAIRMAN. Do you think specifically that we should try to have West Germany assume a larger share of the cost of its military support and also assume a larger share of economic and military aid to Turkey and to India?

Mr. MARTIN. I think we should do everything in our power to get sharing of the problems.

The CHAIRMAN. And West Germany is certainly one of these countries that could do this?

Mr. MARTIN. West Germany has shown remarkable progress and stability.

The CHAIRMAN. Has it contributed to economic and military aid for these countries?

Mr. MARTIN. On a proportionate basis, I am not prepared to say.

The CHAIRMAN. Has it contributed any appreciable amount?

Mr. MARTIN. Yes; I think it has.

The CHAIRMAN. You are satisfied with the contribution of West Germany?

Mr. MARTIN. I have not been working primarily on it.

The CHAIRMAN. You meet with the conclave of international bankers who from time to time speak of their feeling that the American dollar is not on a sound footing and you defend the American dollar. Would one way of defending the American dollar be to get West Germany to assume a larger share and then apprehensions might be quieted?

Mr. MARTIN. Let me make a comment on the broad balance-of-payments problem. We are now facing a problem on interest rates that we have not contended with for some time, where we are talking about economic isolationism in terms of interest rates in a world in which it is no more possible to have economic isolation or political isolation.

The CHAIRMAN. You mean since the British have raised the discount bank rate, that this will require a similar increase in the interest rate in this country?

Mr. MARTIN. I am confident that one of the factors in the British increase was worry about this movement of funds from one country to another.

The CHAIRMAN. You mean out of the United States?

Mr. MARTIN. Not necessarily.

The CHAIRMAN. I do not know whether you watch the rollcalls up here or not, or whether this matter is too unimportant for you to consider, but I have consistently supported foreign aid and military aid for other countries and I have come to the conclusion that the countries in Western Europe, which are doing so extremely well as indicated by all the indexes of production and farmholdings, should assume a larger share of the burden, that this is particularly true of West Germany, but it is also true of Great Britain, and that, with

the increasing stability of France, it can become true of France, though I think we should use a great deal of charity in dealing with that country.

I hope you are not shielding the West Germans in this respect.

Mr. MARTIN. You hope what?

The CHAIRMAN. I hope you are not shielding the West Germans from assuming a larger share of international responsibility. Would that not quiet the apprehensions which they have about the stability of the American dollar?

Mr. MARTIN. I am not trying to shield anyone.

The CHAIRMAN. When you meet with the central bankers, will you not urge that they meet a larger share of these international responsibilities?

Mr. MARTIN. I want to see us have a wider sharing of our international responsibilities because I think that the whole world, as I have testified earlier, is seeking capital today, seeking savings.

The CHAIRMAN. And West Germany should assume a larger share of international responsibility. Is that not true of Great Britain, too?

Mr. MARTIN. I think it is true of a number of countries.

The CHAIRMAN. We are in substantial agreement. What do you think about the quota restrictions upon American goods imposed by West Germany and by Great Britain? They were formerly justified on the ground that there was a shortage of dollars. Now they boast of the large number of American dollars that they have and from time to time indulge in covert threats that if they withdraw these dollars that Uncle Sam will be in difficulty.

Could not their fears about the American dollar be quieted by permitting us to export more and we could do that if we would eliminate the quotas against American goods?

Mr. MARTIN. I favor multilateral nondiscriminatory trade.

The CHAIRMAN. Do you not think there is a great necessity for reform on the part of our British and German brethren?

Mr. MARTIN. I think progress is being made in this area.

The CHAIRMAN. Progress but still a large amount remains to be done, is that true?

Mr. MARTIN. That is correct.

The CHAIRMAN. They have great influence with them. They respect you very much. Could you not urge this upon them and thus help to lessen the strains upon the American dollar and soothe their fears?

Mr. MARTIN. I am doing everything I can to support the stability of the dollar.

The CHAIRMAN. Would you not like to have a little help from Congress in this respect so that you would not have to bear the burden alone?

Mr. MARTIN. Well, I take it that you are offering that help, Senator.

The CHAIRMAN. In a modest way. I do not want to see you bowed with the weight of Hercules upon your shoulders and bearing all of this.

Could we not have been of assistance to you in possibly reducing foreign aid as a stimulus for them to assume some of the load?

Mr. MARTIN. I think the greatest assistance you could give us would be on the expenditure front generally. I am not talking about where these expenditures are cut.

The CHAIRMAN. One way to reduce expenditures would be to reduce foreign aid, which is a very large item.

You see, we were asked to contribute very large sums to the International Monetary Fund and the World Bank last year for which we issued bonds, but we were not told until after this had been approved that we were in a very dangerous position so far as foreign claims upon our balances were concerned. This came after we were urged to generosity and I believe in generosity but I believe in generosity with one's eyes open.

Would it not be very helpful if we made any foreign aid to Turkey or India conditioned on the granting of more foreign aid by West Germany and possibly by Great Britain?

Mr. MARTIN. I have grave question about the desirability of attaching conditions to that type of thing.

The CHAIRMAN. Will you get participation unless there is a little of the stick?

Mr. MARTIN. That is a problem of negotiation and diplomacy and it is not in my field at the moment.

The CHAIRMAN. Would you like to have us help in inducing a greater degree of financial responsibility on the part of the European governments which are shirking their responsibilities thus far?

Mr. MARTIN. I would certainly welcome the support of Congress in every way that it can give it to help us maintain the purchasing power of the dollar.

The CHAIRMAN. But to get West Germany and Great Britain to make a larger contribution to international stability?

Mr. MARTIN. I am not sure that I follow you there, Senator.

The CHAIRMAN. Would you welcome the help of Congress to get Great Britain and West Germany to make a greater contribution to international stability, first to remove the quotas upon American goods for which there is no further justification because of the shortage of dollars. They have the dollars. Second, because we, having borne the burden now for 15 years, find ourselves staggering under the load, and with external movements of gold, is it not time that they, as full-fledged partners, assumed some of this load? And will they assume that burden unless they are strongly urged in that direction? And not only urged but should there not be implication that something may happen unless they do assume that burden?

Mr. MARTIN. I assume that they are being urged and you and I are in complete agreement on liberal trade policies. That is one field where I do not think we have ever had any differences.

The CHAIRMAN. Would you like a resolution which would enable you to go to your international bankers' meeting with a mandate?

Mr. MARTIN. I am not the individual in the Government to negotiate trade.

The CHAIRMAN. But you have a very important influence when the international bankers meet.

Mr. MARTIN. I speak my piece in the National Advisory Council on international monetary and financial policy of the United States, but I am not a negotiator with foreign countries.

The CHAIRMAN. I was filling in for Congressman Patman here, and I thought I would shift the subject until he returned.

I noticed the pleased smile that my good friend from New York had when he advocated the change in our policy toward foreign countries and it proves that we have a great deal in common, Congressman.

Representative KILBURN. Of course, I agree with Mr. Martin that his primary responsibility is the stability of the dollar. I do not imagine that foreign policy is precisely his field or responsibility.

The CHAIRMAN. Congressman Patman.

Representative PATMAN. Mr. Martin, I desire to read just short excerpts from statements of members of your Board. We have it straight now that the commercial banks have no proprietary interest in the Federal Reserve.

Mr. Szymczak testified on April 16, 1958:

> Member banks do not own the Federal Reserve banks.

That was on page 416 of the hearings.

On page 422:

> The central bank having the power to create money does not need any surplus funds and does not need any capital stock. The capital stock was used to start with for operating expenses and has not been used since and is not used now.

Further quoting, on page 422:

> Surplus funds are not used for any purposes. They have never been invested and are idle funds for all practical purposes.

Then Mr. Mills testified about the stock certificates:

> Stock issued by the Federal Reserve banks has none of the attributes of stock certificates.

Mr. J. L. Robertson, a member of your Board, testified:

> Commercial banks holding stock in the Federal Reserve System have no proprietary interest in the Federal System, as such.

Next:

> Surplus funds are purely an accounting matter.

Next:

> The Federal Reserve System could operate just as well without stock ownership and dividends on that stock as with it.

Next:

> If the whole $800 million surplus funds were transferred to the Treasury, it would not interfere in any way with the operation of the Federal Reserve System.

That is before the fund got as high as it is now.

Now then, Mr. Charles Shepardson, another member of your Board, said, "The capital stock and surplus have never been invested."

Next:

> Stock in the Federal Reserve System is not stock in the actual sense of the word "stock." It might be described as a flexible membership fee or a sliding scale membership fee.

Now, Mr. Martin, I cannot understand, when the people, the taxpayers are struggling under the tremendous load of taxes, why you are not willing to turn over that $700 or $750 million more in surplus funds to the Treasury and let that be paid on the national debt so

as to save the taxpayers that much interest. You have turned over $266 million. What I want to know is why you do not turn over the remainder? It is not used for any purpose. It is idle. You have no use for it. You have said that yourself.

Mr. MARTIN. Mr. Patman, I anticipated that this would be your position when we took that up, that you would say "this is fine, but not enough."

Representative PATMAN. That is right.

Mr. MARTIN. I have already pointed out to you that this goes to the heart of the institutional framework of the Federal Reserve System whether it is to be a business procedure and follow business accounting procedures and that some capital and surplus is needed unless we come back under a different system than we have and Congress gives us our appropriations for our operating procedures. That is the heart of the matter.

Representative PATMAN. Mr. Martin, are you not mistaken in saying that this is the heart of the System when you know the heart of the System is your power to create money on the credit of the U.S. Government? That is the heart of the System, is it not?

Mr. MARTIN. I do not conceive it to be such because the power to create money which came into the System was put in the institutional framework of merging public and private interests. Now, that is why we have this present framework. The capital and surplus is for that purpose. There may be a time when we would need it.

With due respect to those quotations, it was the judgment of the Board that this was a reasonable relationship which was followed out in the history of the act, because the franchise tax was in existence until 1933, as you know.

We have tried to get the franchise tax reimposed. It was part of the Financial Institutions Act which died in the House Banking and Currency Committee.

I think we would have preferred to have had the franchise tax but that is a matter of judgment, but we think that it is important that this framework be retained or at least that we know what is happening when you make a basic change.

Representative PATMAN. Mr. Martin, I wish you and your Board would study a plan to deliver to the Treasury the remainder of about $700 million of surplus funds, just as you did the $266 million. Then plan also to pay these private banks their $400 some-odd million in so-called stock, because they are misinterpreting that, Mr. Martin. They think they own the Federal Reserve System, and some of them are becoming what is tantamount to being squatters on Government property. We do not need their money. We are out about $24 million a year paying them interest or dividends on it for no purpose on earth.

You have not invested it. If you invest it in 4-percent or 3-percent bonds you would at least salvage half of it, but you do not do that. It is not used for any purpose.

There is no reason to have it and you ought to pay them back and save that $24 million a year and pay that surplus fund over into the Treasury.

I have here in my hand a copy of your reply to my charges against the Federal Reserve banks that they were wasting and misapplying funds and illegally spending and unlawfully spending public funds.

That was in a speech I made in June 1959; and your reply has just come in. Your reply is over 100 mimeographed pages. It was more than 7 months ago, on June 26 last year, that I released a statement setting out many, many examples of misuse, improper use, and I think illegal use of public funds by various Federal Reserve banks. Your public relations team, it seemed to me, went to work immediately because there promptly appeared editorials in the financial journals and in many of the newspapers of the country to the effect that I had unfairly accused you and had misrepresented the facts. These editorials seemed all cut of the same cloth.

Now, 7 months later, on February 1, 1960, you have transmitted your formal comments on my statement. It appears that you have had a team of writers writing for the full 7 months because your document runs to 107 legal-size pages of single-space type. It is what I believe is called these days a "snow job". You have surrounded the facts I set out with thousands of words of explanation. Yet, when I plow through all of this lengthy explanation, I do not find any item where you have pointed out that my statement of 7 months ago is incorrect in any particular. In point of fact, anyone who has the time to read all this will find that you have made a complete admission to everything I charged. You have just surrounded your confessions with a lot of verbiage and a lot of irrelevancies. To illustrate, let us begin with the first item on the first page of your comments. You began by repeating my statement, then you proceed to answer my statement. My statement was as follows:

The most glaring example of a continuation of an expenditure commented upon in previous reports by the examiners was with respect to Christmas remembrances given by the Chicago bank. In the 1956 reports, the examiners questioned a charge of $1,909 on December 23, 1955, covering expenses of Christmas remembrances to persons other than the bank's own employees who rendered valuable service to the bank during 1955. In the 1957 report, the examiners called attention to the propriety and compliance with the rules and regulations of the Reserve bank and the board of governments. Again in December 1956, Christmas remembrances involving an expenditure of $1,842.40 were commented upon * * *.

Then this is your answer:

The recipients of such gifts have been muncipal and private police, delivery men, equipment servicemen, hotel and transportation reservation clerks, and janitors and elevator operators serving quarters the bank occupies as tenant. It is an established custom in Chicago for business organizations to remember at Christmastime with gifts of cash and merchandise any employees of other organizations who, in the preformance of their regular duties, render service to them in a capacity where the quality of the service could depend to some extent on the personal inclinations of such individuals.

Most cash gifts are $10 a person and the top limit has been $25 for exceptional cases. All cash payments are made by check. The 1955 remembrances, totaling $1,909.94 for cash and merchandise, went to 593 people. The 1956 list had already been prepared at the time of the examination. As this involved in some instances the submission of names of their employees by the service organizations, the Reserve bank stated that it was not possible to remove many names already on the list; however, individual amounts were reduced in a number of instances.

As a result, the expense for that year was $1,867.40 for gifts to 629 individuals. In 1957, however, the list was reduced to 127 individuals and the total cost was $758.69. From a careful analysis of this list, it is the bank's belief that the result represents the minimum conformance to local custom which will assure it of services reasonably comparable with those received by the rest of the business community.

Now, I think we can make these observations:

First, you do not deny that the money was given away or spent for Christmas "remembrances."

Second, you do not claim that this use of public funds is proper. You simply claim that since this practice was first questioned the Chicago bank has cut down on the total amount of the gift giving and has also spread the gift giving around to a larger number of people.

Third, you do give information concerning the recipients of these gifts which was not available before. You claim they were for municipal police, private police, deliverymen, equipment servicemen, hotel and transportation reservation clerks, janitors, and elevator operators. In other words, the picture painted here is that the Federal Reserve bank is distributing its largesse to plain people and people for the most part in rather lowly jobs. Christmastime and all that—though you do not say anything about the poor little old lady who stands in the rain and snow selling violets and bringing a word of cheer and comfort to everybody.

Finally, you do suggest—though you do not claim it—that the level to which you have now reduced this gift giving—only $758.69 in 1957 as compared to $1,867.40 in the previous year—is proper. Thus you say that the 1957 gift giving is believed to represent "the minimum conformance to local custom." I am happy, of course, that this particular item of expense has gone in gifts to financially small and worthy people such as the Chicago police. In total, the expense is very small as compared with the more than $120 million a year the Reserve banks spend in providing free services of all kinds for the private commercial banks. Even so, these facts do not come to grips with the issue. The issue is whether the Federal Reserve banks have any right to spend or give away any amount of public funds for such purposes. I think you have no right; and I think it is illegal.

This is the question I have posed and it has not been answered yet; and I would like an answer. If the Federal Reserve bank in Chicago, or any other city, can give away public funds—funds which would otherwise go back into the U.S. Treasury—for gifts for the local policemen, reservation clerks, elevator operators, and so on, why should not the local post offices and the local tax collection offices and all other Federal agencies in the locality do the same thing?

Now, I have one more question: In view of the 107 pages dealing with extremely serious instances of misuse, abuse, and loose handling of public funds contained in this document, and in view of the fact that most of these same practices have been pointed out before and are still not cleaned up—why would not a public agency under responsible direction and leadership welcome an investigation? Certainly the Federal Reserve's opposition to an investigation leads to no conclusion except it is still trying to hide and cover up matters that should be exposed to the public view.

I submit, Mr. Martin, that you gentlemen, in view of these charges and your admissions of the loose handling of the public funds—and I think you admit to things that indicate illegal and unlawful handling of public funds—should ask the Congress to investigate you and find out whether or not these charges are true.

You can comment if you like, or not comment—either one you want.

Mr. MARTIN. I deny the charges completely, Mr. Patman.

Representative PATMAN. Yes, sir, but you had a confession here.

Mr. MARTIN. That is your interpretation of it.

Representative PATMAN. I have been reading your own language.

Mr. MARTIN. Let me just point out, for example, that post offices do not have a board of directors of citizens elected; that there has been nothing illegal in the expenses and the expenditures made by the Federal Reserve banks. A judgment has to be passed on them and the accounting has been extremely careful and extremely explicit, as is indicated by the audits which you have seen.

The Federal Reserve has never said that we do not welcome an investigation by law, by congressional act. The General Accounting Office was not instructed to be our auditor.

Representative PATMAN. But you objected to the General Accounting Office auditing your books. You would not let them in.

Mr. MARTIN. I do not think they should, under the law. We have nothing to hide in our operations. If the Congress wants to change that law, it can. I think it would be a mistake in central bank procedure and central bank administration, and I think that most of the central banks of the world would agree with me on that.

However, that is neither here nor there. I want to reiterate what I reiterated in the summer when this came up before.

I have had a little experience in business and business institutions and I think the Federal Reserve System is the best audited institution I have ever been connected with.

Representative PATMAN. It is self-auditing.

Mr. MARTIN. We have Haskins and Sells as public auditors come in from the outside. The fact that we have used various peoples of our own as clerks and in helping in the audit doesn't mean a thing; that is done in every place.

Representative PATMAN. Mr. Martin, you said that you had not opposed an investigation. Did you not go to see Judge Smith, chairman of the Rules Committee, and carry a number of books and publications showing what I had brought up in the past and objecting to an investigation to be authorized by the Rules Committee of the House?

Mr. MARTIN. I know of no such case.

Representative PATMAN. You went to see Judge Smith, did you not, in his office in the Rules Committee?

Mr. MARTIN. I may have visited with Judge Smith but I did not take any active part in trying to get Judge Smith. I deny that completely.

Representative PATMAN. May I suggest that maybe the Federal Reserve has started the first payola. This paying the police started way back. That is a sort of payola and I understand that a few of the police, not so many of them, have become involved in Chicago. I do not know how true that is. I hope that the Federal Reserve did not contribute to their delinquency.

Mr. MARTIN. I hope you do not really mean that. You do not really believe that the Federal Reserve started payola?

Representative PATMAN. I do not think you contributed to their delinquency but I do say it is wrong for you to take public funds, and in competition with the public who are the taxpayers, and get

benefits and special privileges for yourself and in some cases foster denying equal service to those who pay the taxes. It could go that far.

Mr. MARTIN. Mr. Patman, your charges, I think, are unwarranted and unjust and I just want to deny them for the record, as I did before.

Representative PATMAN. I think you are wrong in opposing congressional investigation. I think you ought to ask for one.

Mr. MARTIN. I have never opposed a congressional investigation of any sort. And any inference that I went to Judge Smith or anyone else and opposed a congressional investigation is unwarranted and untrue.

Whenever this committee has investigated us, whenever you were chairman of a committee, we have cooperated with anyone and everyone, and we will continue to do so.

Representative PATMAN. Thank you very much, Mr. Martin.

Mr. MARTIN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Javits?

Senator JAVITS. I was not in on this colloquy that our good friend, Congressman Patman, had.

I wanted to leave this. I have come in from the floor on a bill which I was vitally interested in.

I will ask you just one question. When we had the experts before us from the Federal Reserve Board, I asked them what would they do under the impact of a war situation? How would you make an expanded credit quickly available? And I will give you the point of my question because it was not an obscure thing.

I do think we are in a very serious situation. We may suddenly find we are in a serious situation about defense, let us say. We may find the Russians popping up with Lord knows what. So that there is a time when we here ought to know what is the anatomy of this system in terms of putting on a head of steam if we need it which is of an unusual kind.

Now really, all that they said was that the Federal Reserve Board is autonomous, it keeps in touch with the situation, if it thinks there is a demand for more credit, it responds, but if there is to be any policy directive, it must be from the Congress.

"We are responsible," said they, "to the Congress. There is our boss or master," or whatever words they used. That is the whole concept.

I would appreciate it very much, because I think it would be very useful to the country, to find out from you how does the Board conceive of its role in responding to what would be a national emergency whether it is a war or some problem which is all tantamount to the challenge posed to us by war?

Mr. MARTIN. Senator, I think you are familiar with the fact that President Eisenhower, from his past experience, has been particularly interested in the defense planning. We have devoted a great deal of time and attention, one member of the Board of Governors has worked conscientiously and faithfully on this for the past 5 years, and we have participated in all the alerts that have been called by the Government. We have even arranged a succession, a roll of succession not in any fear sense but what would happen in the event of one bank being cut off from another bank, and we have had exer-

cises where we have taken the Open Market Committee and assumed that two-thirds of them were wiped out and what we would do in the event of dealing with the money and credit system under those circumstances, and we have come to the conclusion that martial law probably would have to be invoked and direct controls and all of the other processes that you use in an economy in that sort of situation and try to retain as much as we could of the market system in areas that might not have been affected by an attack.

On the instruments, the instruments of the Federal Reserve policy primarily for this sort of thing, open market operations and reserve requirements and we would intend to use both of them freely.

Senator JAVITS. To make the credit available?

Mr. MARTIN. To make the credit available.

Senator JAVITS. In other words, if the Federal Reserve felt we were in a national emergency now in which larger credit was necessary, which, incidentally, would have an influence on interest credit, Federal Reserve could make it available, so that really the Federal Reserve does base its operations to some extent upon, I was going to use the word "political," but certainly a judgment of statecraft?

Mr. MARTIN. Certainly, yes.

Senator JAVITS. There it would take its cue from whom, the President or Congress or whom? To whom would it listen?

Mr. MARTIN. I would think that in the event of an emergency that the President and the Secretary of the Treasury might become the key people.

Senator JAVITS. I see. So you go along with your people that it is the Congress that is their master?

Mr. MARTIN. I would say under those circumstances that the Congress would give almost immediately whatever authority was required.

Senator JAVITS. Then you feel that with the two twin tools of open market purchases and the reserves you could make the necessary credit available to enable the country to meet a challenge?

Mr. MARTIN. I do.

Senator JAVITS. You could do that whether there was a shooting war or not, could you not?

Mr. MARTIN. We could, indeed. There are problems that we have been working on, such as this problem of indemnification for war losses because in the sense of having a going economy and the extent to which the Government could make indemnification for war losses is something that is being studied actively by Governor Hoegh and the Office of Civil and Defense Mobilization with our people and with the other departments of Government.

Senator JAVITS. I have to go and vote.

I would like to pursue this with you. I know you appear before us from time to time. I hope I will have another occasion to do that.

Thank you very much.

(The following article is inserted in accordance with the committee discussion at the morning session, Feb. 4, 1960—pp. 257-259.)

[From Business Week, Jan. 30, 1960]

GOVERNMENT—MARTIN, THE MONEY MAN, HEADS INTO A FIGHT

THE FEDERAL RESERVE'S CHAIRMAN LIKES TO STAY ALOOF FROM POLITICS, BUT HE FACES ELECTION YEAR TIFF OVER TIGHT MONEY

For almost 9 years, 54-year-old William McChesney Martin has weathered the storms associated with his job as Chairman of the seven-man Federal Reserve Board, the body responsible for controlling the Nation's money supply. The Fed, like the Supreme Court, is supposed to be independent of both Congress and the White House, and thus removed from the heat of political controversy. But Martin, a nominal Democrat who was first appointed by Truman and then reappointed by Eisenhower, is now in the thick of a looming political fight over tight money.

Martin has been embroiled in some fights before, but none of them ever reached the critical stage. This time, though, he faces the potent combination of an election year and the highest money rates since the 1920's. The administration feels that tight money is essential if the United States is to achieve a balanced budget and a stable dollar. But the Democrats are anxious to do battle on the ground that these policies may prevent the Nation from attaining the added growth needed to meet the Russian challenge.

Fighter for orthodoxy.—In his battle, Martin is clearly on the side of stability. An apparently mild-mannered and reserved public servant without political ambitions of his own, he does not relish involving the Fed in politics. At the same time, he is not running away from any fight: He is prepared for a spirited defense of his orthodox policies of monetary management.

Martin's power—and his importance to politicians—stems from his position as head of the Nation's central bank, which controls the amount of reserves held by the banking system—thus determining how much money, and at what price, banks can lend. The crucial responsibility gives the Fed a major role in shaping overall economic trends and makes Martin a key figure among the Nation's policymakers.

To Martin, his job is strictly nonpartisan. And he has a measure of bipartisan support. In fact, most Democratic politicians agree with his view that credit should become scarcer and interest rates higher during periods of economic prosperity. But even these men think he has been pressing on the brakes too hard and too fast. They know the Fed is independent of the White House, but they also feel Martin's policy of restraint is geared nonetheless to the administration's conservative line.

I. *The lines of battle*

In the disputes to come, Martin and the administration will be linked on many fronts. For example, he is sure to figure in the White House fight to lift the 4¼ percent interest rate ceiling on long-term Treasury bonds. Last summer, when the House Ways and Means Committee moved to lift the ceiling, it attached a rider suggesting that the Fed buy long-term Treasuries (rather than Government bills) when it wanted to ease rates. Martin felt that this advice, mild as it was, should not be part of any legislation bearing on the Treasury, and he got the support of President Eisenhower and Treasury Secretary Robert B. Anderson. Congress then refused to lift the ceiling.

Now the administration is making a new request, and Congress may again attach a rider applying to the Fed. Martin is sure to oppose it. Though he feels that Congress has the right to lay down the law to him, he insists that it should be done directly—through amendment of the Federal Reserve Act—and not in roundabout fashion.

Classic rules.—Martin will also be under fire for acting as if the old gold standard rules still apply. Under the gold standard, if a country suffered a deficit in its balance of payments, it had to ship gold to its creditor nations. This reduced its own gold reserves and, in turn, its money supply. Eventually, the result was a decline in business activity, employment, and prices. When prices dropped low enough, exports increased again, the balance of payments swung back into favorable position, and gold flowed back into the country.

Critics say Martin is following the orthodox rule of tightening the money supply at a time when the United States has a balance of payments problem. They fear this may land us in an international war of interest rates. This charge was heightened last week when the Bank of England upped its bank rate to 5 percent—a full point above the Fed's discount rate. Martin, these critics feel,

will push for even higher rates—which would help keep foreign funds in the United States but would also put a further squeeze on domestic borrowers.

In traditional central bank style, Martin refuses to tip has hand. But he is convinced that the U.S. economy—and the dollar—cannot stand in splendid isolation from the rest of the world. At the same time, he by no means thinks a deflationary purge of the old-fashioned gold standard sort is needed to solve the balance of payments problem.

He also rejects the notion that tight money will crimp the economy; as he sees it, the one sure way to invite a bust would be via a cheap money policy that would bring an unstable boom. The way to grow, he says, is to increase savings, and he insists he favors "the lowest rate that is consistent" with maximum savings.

Sticking to his guns.—Some Wall Street observers think that despite his convictions, Martin will avoid a head-on fight by subtly easing credit sometime later this year. They reason that he does not want to jeopardize the administration's chances in the election. In the 1952 campaign he delayed putting through a rise in the discount rate until after Eisenhower's victory. This, they claim, may happen again.

But this view fails to take into account the changes that have taken place in the administration, in the public mood—and in Martin himself. In 1952, he had only recently come to the Fed, and he was disposed to act cautiously, for fear of provoking a fight within the system or with Truman's administration. Even in the 1955 boom, when there was no election to worry about, Martin moved slowly in tightening.

Now he is much more secure. He is not, as some of his critics charge, bold and belligerent and "out for blood." On the other hand, he is not so meek and self-effacing as some of his admirers claim. He is, in fact, a complex and enigmatic personality. There is no doubt, however, that he will stand by his convictions with the fervor of a man who has discovered religion.

II. Shaping a policy

Martin's basic tenets are few. He believes that monetary management cannot do the whole job of maintaining economic stability. But as long as other weapons are not being used effectively, he feels that the Fed should not shrink from using all its guns. However, he believes that he should intervene as little as possible with the workings of the free market.

These principles are now standard operating procedure. Indeed, a great deal of Martin's time has been spent in reshaping and reforging the Fed to his particular notions. Today, the Fed is what Martin has made it.

Flexibility works.—Martin's biggest achievement has been in proving that a flexible monetary policy had a role to play. His arrival at the Fed coincided with the Fed-Treasury accord of 1951, which freed the money managers from having to support the Government bond market. At the time, there was grave doubt about the use of such flexible monetary policy in the hands of an independent Fed; for the tools of monetary management had been found wanting in the 1920's and 1930's.

The past 9 years have shown that monetary policy can be an effective force in the economy. True, inflationary developments have not been prevented, but Martin says, not unmodestly, that conditions would have been much worse without the Fed on the scene. The use of a flexible policy has also meant extremely wide fluctuations in the Government bond market, but this is the price of trying to maintain overall stability.

Martin admits that some mistakes have been made in setting policy. Yet none of them was fatal; in fact, any appraisal of Martin's role must take into account the fact that the Fed, under his stewardship, has had no choice but orthodoxy. For during most of the 1950's, deficit spending and inflationary financing were the rule. Moreover, the majority of wage settlements stimulated price rises. The Fed, according to Martin, had "to lean against the wind" all alone.

III. Inside the Fed

Martin feels he has accomplished a great deal within the Fed itself. In pre-Martin days, there was always a struggle for supremacy between the Fed headquarters in Washington and the New York Fed, which had a special status because of its place in the Nation's money market. Today, there is no question that Washington is in the driver's seat and that the driver is Martin himself.

But he did not win without a fight. His opponent was Allan Sproul, president of the New York Fed from 1941 to 1956, and generally regarded as the Nation's

most able and experienced central banker. In essence, the Sproul-Martin fight was over how much managing the money managers should do: Martin plumped for a limited role, Sproul for a more active one.

Martin won victory by getting the other regional Fed banks, which had always resented the special role played by New York, on his side. He did this by "democratizing" the Fed, holding more frequent and regular sessions of the 12-man Open Market Committee and eliminating its 5-man executive committee, which had formerly made most of the decisions. As a byproduct, a great many more people become privy to policymaking. This ended the tradition of "internal secrecy" under which only a handful of men—in New York and Washington—were in the know.

Changing officers.—In the past 9 years, a great many top-level personnel shifts have been made, and Martin has had a hand in most of them. He has seen to it that the chief officers in the regional Feds are central bankers as well as administrators. He has stressed the need for improving economic research.

Most economists acknowledge that the Fed's research team is the best in Washington, possessing an abundance of both theoretical knowledge and practical knowhow. There is a sort of Teutonic thoroughness about their work, impressive both in its scope and its attention to detail. Nevertheless, many economists feel the Fed's staff often seems closed-minded.

Martin leans heavily on his own research staff, headed by a triumvirate of Winfield Riefler, Woodlief Thomas, and Ralph Young, Riefler has just retired from his post as Assistant to the Chairman, and his place will be hard to fill; of all the Fed's economists, he was the most sophisticated and imaginative. A big influence on Martin, he provided much of the theoretical support for the Fed's orthodoxy.

IV. Tools of the trade

The conservative path the Fed has followed under Martin is most evident in his use of the Fed's weapons. He is a firm believer in general and indirect controls; except for margin requirements on stock market credit, he has not been in favor of any specific credit controls.

In this respect, his own orthodoxy is much purer than that of the Bank of England, the oldest of central banks. It has not been afraid of innovating in an effort to bolster the general and indirect controls it possesses.

In fact, the Fed is about the only central bank that has turned its back on new ideas. In Canada, for example, the discount rate has been tied to the bill rate; in many other countries selective controls over consumer credit and over long-term capital borrowings have been tried; even in West Germany, which has been a center of monetary orthodoxy, the central bank has a specific means of regulating credit through a series of controls governing the lending power of commercial banks.

Methods available.—But the Fed, under Martin, has rejected any innovations. It has relied on the orthodox weapons at hand.

There are a number of ways that an orthodox central bank can influence reserves. It can make a prompt and powerful change by lowering or raising reserve requirements. Or it can lower or raise its discount rate, which has the effect of making member bank borrowing from the Fed either cheaper or more expensive. It can also operate in the open market, by selling Government securities out of its portfolio, which reduces reserves, or by making purchases, which increases them.

Under Martin, the Fed has made relatively little use of reserve requirement changes. In the past 9 years, this weapon has been used only to ease credit. In 1953 and again in 1958, it lowered reserve requirements in order to stimulate borrowing. Martin obviously regards it as a one-way weapon that has very limited use.

Favored weapons.—He has placed much more reliance on changes in the discount rate and on open market operations. These orthodox weapons have the advantage of greater flexibility; they enable the Fed to feel its way before definitely committing itself. As such, they are much more in keeping with Martin's personal predilections.

There has been nothing bold, for instance, about his use of discount policy. Unlike the Bank of England, which increased its rate from 5 percent to 7 percent when it felt that shock treatment was needed in September 1957, and only last week went up a full point, discount changes have been made only in fractions all during Martin's reign. And more often than not, the discount rate has not been used to give the market a clear signal of which way credit policy is headed. Instead it has tended to adjust to changes in the market itself.

The decision to make changes in the discount rate is primarily the responsibility of each regional Fed. But the decisions must be approved by Washington, which means that Martin is in a position to suggest changes. It may well be that his policy of fractional changes stems from a desire to get all the Fed banks to go along with him; but it may also be due to his wish to avoid a real battle with the easy money enthusiasts in Congress.

Market dealings.—Actually, Martin has placed greatest reliance on open-market operations. In this sphere, he has narrowed the Fed's scope by confining most of its transactions to bills.

Martin's "bills only" doctrine has many critics. The latest staff report of the congressional Joint Economic Committee, for example, lambastes the Fed's "doctrinaire" demands that the money managers "have some responsibility for the structure of interest rates." And "bills only" was a big issue in Martin's fight with Sproul, who believed there are times when the Fed should deal in other securities in order to bring about a swift change in rates.

To Martin, the notion of confining operations to bills is of a piece with his championing of the free market. He contends that the Fed's main concern must be the level of reserves held by the banking system, not the level of interest rates. At the same time, though, he has occasionally traded in other securities, which suggests that he has adopted Sproul's "bills usually" policy when it has suited his purpose.

V. Not quite independent

Martin says that since the Fed is responsible to Congress, which has constitutional authority for regulating the money supply, the Fed will conform to its wishes. If, for example, Congress decided to establish standby authority over consumer credit, Martin would agree to handle it.

The one thing he will fight for is the Fed's independence in policymaking. He thinks the Fed must be free to do its job as it sees fit. If it gets involved in political considerations, then it would lose the objectivity he feels is essential.

But Martin recognizes that independence is not an absolute. For example, he realizes that the U.S. Treasury is in a special position as a borrower. So even though the Fed no longer supports Treasury issues, it tries to maintain a neutral position whenever the Treasury comes to market. This cuts down on its own freedom to act, but Martin accepts this limitation.

Implicit danger.—In fact, Martin faces a continual threat that Congress will step in and limit his freedom. Over the past 9 years, Martin has shown himself remarkably adept at attaining maximum freedom of action without running into trouble. He has sometimes annoyed the administration, but never to the point of having to resign; and he has frequently annoyed Congress, but never to the point of a showdown.

Some politicians think that Martin has led a charmed life—but that he may be running into trouble now. He himself thinks that for the first time in a long while, the Fed will be getting some help in its fight for stability. He thinks the steel settlement was not inflationary; he also feels that the public will resist any inflationary price hikes. And if the administration is able to achieve its objective of a balanced budget, the Fed's burden will be eased.

Martin, however, is taking no chances. He feels that any relaxation might prove disastrous because, from his standpoint, the fight to maintain stability is a continuous one, with many skirmishes but no final victory. And though he admits to some defeats, he feels that the Fed is in better shape to do battle today than at any time in his reign.

Representative KILBURN (presiding). Mr. Martin, Chairman Douglas asked me to act as chairman.

It ought to be a pretty good time for me to have a lot of fun.

I think we are all through, however and we appreciate very much hearing from you.

I am, of course, very glad to learn that the spirit of Christmas still operates in your bank in Chicago as it does in so many places about that time of year.

For the record, tomorrow we will meet at 10 o'clock here on the current fiscal monetary policy recommendation panel discussions.

We stand adjourned.

(Whereupon, at 4:55 p.m., the committee adjourned, to reconvene at 10 a.m., Wednesday, February 3, 1960.)

JANUARY 1960 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 3, 1960

U.S. CONGRESS,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in the old Supreme Court chamber, the Capitol, Hon. Paul H. Douglas (chairman of the committee) presiding.

Present: Senator Douglas; Representatives Patman, Coffin, Curtis, Kilburn, and Bolling.

The CHAIRMAN. The committee will come to order.

We are very glad to welcome two gentlemen who have given good service not only to the committee but to the country and who are going to discuss monetary policy and fiscal policy, respectively.

I am going to ask that the first statement to be presented be by Mr. Smith, and then if Mr. Musgrave will excuse us, we will have some discussion of Mr. Smith's paper, after which you can read your paper, if you would, Mr. Musgrave. Is that satisfactory to you?

Mr. MUSGRAVE. Yes, indeed.

The CHAIRMAN. Thank you very much.

Mr. Smith.

STATEMENT OF WARREN L. SMITH, FROM THE UNIVERSITY OF MICHIGAN

Mr. SMITH. Thank you very much, Senator Douglas.

I want to talk a little bit about the economic situation in 1959, particularly with respect to monetary policy, and then about the year 1960.

The year 1959 was one of strong economic growth and expansion, despite the retarding effects of the 116-day steel strike. It was a year in which recovery from the recession of 1957-58 gained momentum, and in many ways it resembled the other postwar recovery years 1950 and 1955, particularly the latter year. GNP valued at 1954 prices rose from $399 billion in 1958 to $425.6 billion in 1959, a rise of 6.7 percent. This compares with an increase of 8.1 percent in 1955, and it seems likely that if it had not been for the steel strike which was primarily responsible for a dip in GNP in the second half of the year, the 1955 rate of expansion would have been matched. As in 1955, nearly all categories of final demand participated in the expansion during 1959. There were especially sharp expansions in consumer goods and in residential construction in both years.

Monetary policy in 1959, however, was very much more restrictive than in 1955; furthermore, money was considerably tighter at the beginning of the year than it was in 1955. In 1959, the money supply (demand adjusted plus currency outside banks) increased by $0.8 billion or 0.6 percent; the increase during 1955 was $3.8 billion or 2.8 percent. After falling to very low levels in mid-1958 as a result of the recession and easy money, interest rates rose sharply in the latter half of 1958; as early as September of that year long-term interest rates were back to the relatively high levels reached at the peak of the tight money period in 1957.

From that point the rise continued through the remainder of 1958 and in 1959. Short-term rates rose even more sharply, and by the end of 1959 interest rates in general were at their highest levels in a quarter of a century. The restrictive character of monetary policy during 1959 is also indicated by the reserve position of the banking system. Member bank free reserves (excess reserves less borrowings from the Federal Reserve banks) were negative throughout the year, averaging a negative $350 million for the year as a whole and amounting to approximately a negative $500 million during most of the latter half of the year.

There is not much evidence that the restrictive monetary policy followed in 1959 had a very pronounced impact on the economy. Despite the fact that the money supply increased only very slightly, less than a billion dollars, total loans of commercial banks increased by $12.8 billion or 13 percent. The funds needed to cover this loan expansion came chiefly from the liquidation of $7.8 billion of Treasury securities, as Mr. Martin indicated yesterday, together with an expansion of $3.1 billion in time deposits.

Comparison with 1955 is of some interest. In that year, total bank loans expanded by $12 billion or 16.2 percent, with liquidations of Treasury securities amounting to $7 billion and time deposit expansion to $3.1 billion. When commercial banks sell Government securities and use the proceeds to expand loans, an increase in the velocity of monetary circulation tends to result, with expansionary consequences. Between the fourth quarter of 1958 and the fourth quarter of 1959, income velocity (GNP divided by money supply) increased from a rate of 3.28 per year to 3.34, a rise of 4.8 percent. The increase for the same period in 1954–55 was 7.3 percent.

In his testimony yesterday, Mr. Martin stressed the importance of monetary policy and rising interest rates as a factor tending to increase saving. If you look at the situation in 1959, however, there certainly is no evidence that the rising interest rates encouraged saving, since personal saving was slightly smaller in 1959 than in 1958.

Representative PATMAN. Are you quoting Mr. Martin now?

Mr. SMITH. Not, not now.

Representative PATMAN. Who are you quoting on that point that higher interest does not produce savings?

Mr. SMITH. I didn't mean to say that. I said Mr. Martin yesterday emphasized the fact that rising interest rates in 1958 and 1959 did tend to increase savings.

Representative PATMAN. Did increase savings?

Mr. SMITH. I am saying that personal saving in 1959 actually was $23.3 billion, or 7 percent of disposable income, and the year before it was slightly higher, $23.5 billion, or 7.4 percent.

The CHAIRMAN. That is, though the interest rate rose, savings formed a smaller percentage of personal income?

Mr. SMITH. It was very slightly smaller in absolute terms and significantly smaller as a percent of disposable income.

Representative PATMAN. When interest rates were low in 1955 and 1956, savings were up high.

Mr. SMITH. Well, I am saying that if anything there was a slight inverse relationship there.

Representative PATMAN. I see. Excuse me.

Mr. SMITH. Commercial bank loans and investments and the velocity of circulation exhibited tendencies in 1959 quite similar to those that prevailed in 1955. If it had not been for the prolonged steel strike and the accompanying liquidation of inventories and slowing down of economic expansion, it seems likely that the growth of bank loans and the increase of velocity in 1959 would have been even larger.

Like 1955, the year 1959 was characterized by a very large increase in consumer and mortgage credit. Both consumer credit extensions and the increase in outstanding credit were larger in 1959 than in 1955, although the percentage increase in outstanding credit was not as great. The same is true of the increase in mortgage debt outstanding. Again as in 1955, tightening credit appears to have had some effect on residential construction. Private housing starts, on a seasonally adjusted basis, reached extremely high levels early in 1959 but began to taper off somewhat late in the year as conditions in the mortgage market became tighter. For the year as a whole, housing starts were only slightly below the record year 1950.

The business outlook for 1960 is generally favorable, as several people have testified before the committee. Business spending on plant and equipment has been rising steadily but slowly since the third quarter of 1958, and surveys of investment plans suggest a continuation of this rise. Since the settlement of the steel strike, the steel industry has announced a large investment-spending program for 1960.

Consumer incomes have been rising steadily, and the outlook for durable goods spending seems good but not sensational. A rise in Government spending is anticipated. A substantial rate of inventory investment should occur in the first half of the year, partly as a backwash of the steel strike. However, there are some adverse features in the present situation. Unemployment is still relatively high, and there is considerable underutilized productive capacity. As Mr. Henle pointed out in his testimony, there will be a relatively large increase in the labor force. Thus, it appears that even if some of the relatively optimistic forecasts turn out to be correct, the economy will operate substantially short of its capacity for 1960 as a whole. One of the uncertainties in the business situation is the possible impact of tight credit. The credit markets have eased slightly recently, but this is quite clearly a seasonal tendency related to the return flow of currency from circulation and the repayment of seasonal loans which regularly occurs at the beginning of the year.

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The Federal Reserve has been acting vigorously to counteract the forces tending toward credit easing. It is clear that the System views inflation as the chief problem and that it intends to use its powers vigorously in an effort to maintain a stable price level. Inflation does seem a distinct probability in 1960, but it is by no means clear that the inflation will be of the kind that can be effectively prevented by tight credit.

The large wage increases that have occurred in many industries in 1959 probably presage further substantial increases in 1960 as the pattern spreads. Moreover, rising corporate profits, which are almost certain to prevail if prosperity continues, will offer a further incentive to large wage demands. The prices of services, such as medical care, have risen steadily in recent years, and the rise is likely to continue. A sharp upsurge in plant and equipment expenditures is likely to develop with an attendant rise in prices of capital goods. The impact of monetary stringency on the process of collective bargaining and on the factors determining the prices of services is very indirect and weak, and recent experience suggests that tight money is not very effective in controlling plant and equipment spending. On the other hand, monetary restrictions may very well have effects on other sectors of the economy which will serve to slow down the rate of expansion of output without having appreciable effects on inflationary pressures.

Thus, there is danger that we will experience a repetition of the situation which developed in 1956 and 1957. It appears that in those years excessively restrictive monetary-fiscal policies slowed down the rate of expansion. Real output rose no more than in pace with employment despite heavy investment in new productive facilities, so that there was no rise in productivity per worker for the economy as a whole, while at the same time substantial increases in the price level took place.

As a matter of fact, in the present circumstances it seems possible that an excessively stringent monetary policy could have a considerably more drastic expansion-retarding effect than it had in 1956. At the present time, interest rates are not only much higher than they were at the end of 1955 but are actually considerably above the levels that prevailed at the height of the previous period of tight money in 1957. There is some evidence of a substantial lag in the effect of interest rates on plant and equipment expenditures, and the slow response of investment to rising business activity may be partly a result of the fact that interest rates were permitted to rise quite sharply early in the recovery period. For all commercial banks, holdings of Government securities were 30.7 percent of total loans and investments at the end of 1959, compared with 38.3 percent at the end of 1955 and 34.2 percent at the end of 1957, when the effects of the last previous phase of credit tightening were still present.

Thus, the liquidity of the banking system has been noticeably reduced, and credit restriction in 1960 may take hold more firmly than heretofore. It may be noted, on the other hand, that bank liquidity is still apparently much more ample than it was in the 1920's, and a very considerable further shift in the composition of bank portfolios from Government securities to loans seems to be

quite possible. Income velocity in 1929 reached a level of approximately 4 times per year, or about 16 percent higher than the present level. In view of the techniques for economizing cash balances that have been developed in recent years, it seems quite possible that velocity could rise to the 1929 level or higher. Such an increase at present levels of money supply would be sufficient to finance a very large expansion indeed.

Thus, it appears that in general there may still be a considerable amount of "play" in the financial system which will weaken the effectiveness of monetary policy. Nevertheless, a significant impact on certain sectors of the economy does seem to be a distinct possibility. Residential construction appears to be feeling the effects of the credit squeeze already, and unless something is done about it, the effects are likely to become greater. If the banks begin to tighten credit standards and reduce the availability of loans, the effects are likely to be concentrated on new and relatively small businesses. Rising interest rates may also hurt the ability of State and municipal governments to finance public facilities, such as schools and highways. The danger is that due to lack of resource mobility and rigidities in the price structure, cutbacks in these sectors will reduce output and employment without doing much to prevent inflation.

Much has been made of the fact that the prospective budget surpluses in the first half of calendar 1960 and for fiscal 1961 will tend to lessen monetary pressures. A cash surplus of approximately $6.3 billion is apparently expected for the first half of 1960, which will permit a reduction of the publicly held debt of approximately that amount. This contrasts with a cash deficit of $0.5 billion in the first half of 1959.

In addition, the publicly held portion of securities other than Treasury bills which will mature in the first half of 1960 is somewhat smaller than the amount which matured in the first half of 1959. Thus, it is true that the Treasury will be putting funds into the capital market through debt retirement in the months to come, rather than draining funds out of the market as it has been doing, and also that the strain imposed on the market by refunding operations will be greatly reduced.

However, the easing effects of these changes are very likely to be more than compensated for by rising private demands for credit and by further restrictive actions by the Federal Reserve if expansion and inflationary tendencies continue. In fact, the easing of the Treasury's debt management problems will increase the Federal Reserve's freedom of action in applying a restrictive policy.

The prospective surplus for fiscal 1961, amounting to $5.9 billion on a cash basis, has been heralded as indicative of increased reliance on fiscal policy, thus leaving a smaller share of the burden of economic stabilization to be shouldered by monetary policy. However, all but approximately $700 million of the proposed surplus is scheduled to result from rising tax collections resulting from economic expansion; that is, from the working of automatic fiscal stabilizers during a period when incomes are expected to expand.

Use of such a surplus if it should materialize, to retire debt, would tend to ease conditions in the capital markets and result in lower in-

terest rates. However, unless the direct effects of the budget surplus on the flow of income should significantly moderate inflationary tendencies, it can be presumed that the Federal Reserve will take compensating action, even though perhaps mistakenly, to tighten credit. It seems to me this is likely to be the case, because inflationary tendencies of the sort we appear to be faced with are not likely to be much moderated by automatic fiscal policy; accordingly, it is by no means certain that the budget surplus will lead to an easing of monetary restrictions.

To summarize, it appears that we are again, as in 1956, running the risk of locking the economy in a tight credit squeeze which will hold back economic expansion and growth without dealing effectively with the inflation it is designed to check. In fact, it is probably impossible to deal effectively with the kind of inflationary problem we are faced with by means of the tools presently at our disposal. Pending the development of more appropriate and effective tools, it seems desirable to reduce the amount of emphasis on price level stability and to increase the emphasis on growth and employment in the formulation of monetary policy.

The CHAIRMAN. Thank you very much, Mr. Smith. The conclusions to which you come are the same conclusions that the majority of this committee adopted in the committee report of last week. I may say we adopted those recommendations in large part because this seemed to be the consensus of the nonpolitical experts whom we asked to help us.

I would like to address my questions not so much to the short-run as to the long-run policy of the Federal Reserve Board. Assuming that there is a secular growth in the gross national product, of course the supply of credit should increase at approximately that same rate. Is that not true?

Mr. SMITH. I would say approximately, yes.

The CHAIRMAN. Yes.

In the past, the rate of growth over long periods of time has been around 3 percent. We believe that it could be raised without inflation to 4.5 percent. The present supply of credit, normally taken as demand deposits, is approximately $113 billion; is that not true?

Mr. SMITH. That sounds right.

The CHAIRMAN. And this is built up by member bank reserves of approximately $18 billion.

Mr. SMITH. Right.

The CHAIRMAN. So the member bank reserves are about 16 percent of the amount of credit created by the commercial banks; that is correct, is it not?

Mr. SMITH. That is roughly correct. I don't have the exact numbers in my head.

The CHAIRMAN. Yes.

Chairman Martin has again and again stated that he believes these reserve ratios are too high, and that they should be reduced, and the banks have indicated they would like to be the 10-percent ratio, which is roughly the ratio of the British and German banking systems.

If you were to do this, upon the basis of $18 billion of member bank reserves, this would permit the banks to create $180 billion, approximately, of demand deposits; is that not true?

Mr. SMITH. Yes, sir.

The CHAIRMAN. Or $67 billion more than they have now created; and there would be no added cost to the banks for the creation of the $67 billion, would there?

Mr. SMITH. Except whatever additional costs of operation were connected with the administration of larger portfolios.

The CHAIRMAN. But I mean, there would be no deduction except operating costs for the added volume of business. They would create the $67 billion of purchasing power without paying a fee to the Government. Is that not true?

Mr. SMITH. That is right.

The CHAIRMAN. The Constitution gives to Congress the power to coin money and regulate the value thereof; is that not true?

Mr. SMITH. That is right.

The CHAIRMAN. This includes not only coins, but other forms of currency, does it not?

Mr. SMITH. That is right.

The CHAIRMAN. And does it not also include the creation of monetary purchasing power such as credit?

Mr. SMITH. It is usually interpreted that way.

The CHAIRMAN. Yes, this is taken as part of the money supply.

And the Federal Reserve Board can regulate the amount.

As long as the 16 percent reserve is maintained, if it were maintained, for the banks to increase demand deposits from $113 billion to $180 billion, or increase their figure by $67 billion, they would have to accumulate reserves, added reserves, of approximately $11 billion. Is that not true?

Mr. SMITH. It sounds right.

The CHAIRMAN. The way that these reserves would be built up would be for the Federal Reserve Board to go into the open market and buy Government securities; is that not so?

Mr. SMITH That is right.

The CHAIRMAN. And then the checks which the Federal Reserve Board gives for these securities would be deposited by the sellers in banks, and the banks in turn would deposit these claims in the Federal Reserve, and member bank reserves would be built up in that way?

Mr. SMITH. That is right.

The CHAIRMAN. In that process, if you were to hold the 16 percent ratio, the Federal Reserve would have to buy around $11 billion of the Government bonds; but it would pay for them with deposits which it itself would create; is that not the point?

Mr. SMITH. That is right.

The CHAIRMAN. It would simply create the deposits. These, therefore, would be added capital assets of the Federal Reserve; is that not true?

Mr. SMITH. Right.

The CHAIRMAN. And they would draw interest?

Mr. SMITH. Yes.

The CHAIRMAN. When the full $11 billion had been accumulated, assuming a 4 percent interest rate, although we hope it won't be as high as that, this would yield an added annual revenue to the Federal Reserve of approximately $440 million a year.

Mr. SMITH. Right.

The CHAIRMAN. Depending on the rate of growth.

And under the practices of the Federal Reserve, which I think could not be violated, because if they were violated, Congress would pass an act, 90 percent of the profits of the Federal Reserve are turned over to the Treasury.

Mr. SMITH. Right.

The CHAIRMAN. So that, in effect, at present, on the creation of credit, the Treasury gets a commission of approximately one-sixth; is that not right?

Mr. SMITH. Yes.

The CHAIRMAN. And it gets this commission in return for granting to the private banks the privilege of creating monetary purchasing power which, although it may not be legal tender or payment for debt, is nevertheless, for practical commercial purposes, money; is that not true?

Mr. SMITH. That is right.

The CHAIRMAN. Now then, this is the issue, really: At a 3-percent growth rate, it would take somewhere around 16 years to expand the credit supply by the 60 percent involved. At a 4-percent rate I think it would take something like 12 years. These computations involving compound rates are generally, although perhaps not precisely correct.

The issue, I think, is whether in the next 12 to 16 years the Federal Reserve is going to make an outright present of this additional $67 billion in purchasing power to the banks, or whether it is going to charge the existing commission of one-sixth. If it resorts to open-market purchases, which many of us are trying to get the Federal Reserve to adopt, it will retain this commission of a sixth. If it reduces the reserve ratios, which is the method advocated by Chairman Martin, the Government will not receive this commission, and will not receive the interest.

So there is involved in this question a matter of at least $11 billion, and an ultimate annual income of at least $450 million a year, which will accumulate as in the prior years.

I have been impressed with the fact that this issue does not seem to be understood by many of the financial writers, and is not understood by the American people. I wondered if you would be willing to make a comment on this.

Mr. SMITH. Yes; I have several comments to make.

I think as far as the interest saving to the Treasury is concerned, your calculations are at least approximately right. I agree with these. There might be another saving, which I think would be relatively small, and that would arise from the fact that when the Federal Reserve buys these securities it tends to drive up their prices.

The CHAIRMAN. And therefore lower the yield.

Mr. SMITH. Yes.

The CHAIRMAN. And therefore lower the interest rate. I made this point with Chairman Martin yesterday.

Mr. SMITH. But I don't think that can be carried very far, because we have to assume that the Federal Reserve has a stabilization objective in mind of some kind. Let's say for stabilization purposes they have an interest rate level they want to achieve. That would mean you would get some benefit out of this, to the extent that you would reduce the amount of Government debt so that it became scarcer, rela-

tive to total debt, and the yields on Government securities would fall relatively to the yields on other securities. I do not personally think this would be a very large amount of saving, but it would be a little in addition to the flow through the Federal Reserve.

The CHAIRMAN. Yes; very good.

Mr. SMITH. On the other hand, I think there are some other factors to consider. One of the things that very frequently comes up in this connection is the question of the profits of the banking system. It is usually said that under a procedure of open market operations and keeping reserve requirements up as compared with reducing them, the profits of the banking system would be somewhat lower than they would be if the reserves were supplied by lowering reserve requirements.

The CHAIRMAN. Of course, that is true. The question is whether the earnings of the banking system now are inadequate.

Mr. SMITH. That is right. That is one question. Also, I think there is a little question as to whether bank profits are likely to be affected in the indicated way.

The CHAIRMAN. Whether they are or not?

Mr. SMITH. There are several different assumptions one might make. The assumption you are making, for example, is that the growth of the money supply is the same either way. An alternative assumption that we might make is that the supply of credit is the thing the Federal Reserve is trying to control; and this leads to a little different result.

The CHAIRMAN. I do not know whether you were here when Mr. Martin testified, but he admitted that there was no real difference in the ultimate result to be obtained by open market operations as compared to lowering reserve ratios; that ultimately, they had the same effect on the expansion of bank credit, although in periods of recession he thought the lowering of reserve ratios had a more immediate effect.

Mr. SMITH. I don't think they have quite the same effect, because the amount of credit relative to the amount of money created is smaller for higher reserve requirements than it is for lower reserve requirements. On the other hand, I do not agree with Mr. Martin that there is an important difference in the immediate impact of reserve requirement changes compared with open market operations. That is, I do not think there is an appreciably greater gain in a recession period in attacking the problem by lowering the reserve requirements compared with buying securities in the open market, because the reserves move rather rapidly through the economy and because monetary policy takes hold so slowly anyhow that a lag of the kind involved here is not very important.

The CHAIRMAN. So you would say the short-run advantage he claimed for lowering reserve ratios does not in fact exist?

Mr. SMITH. I cannot see it.

But it is true that if you assume that the money supply grows at the same rate, and if banks maintain the same mix between Government securities and loans, and so on, in their portfolios, bank profits would be somewhat lower with higher reserve requirements than with open market operations.

The CHAIRMAN. Have you formed any conclusions as to whether bank earnings are now inadequate in comparison with industry and in comparison with the risk which banks run?

Mr. SMITH. That is a hard question to answer. However, I see no reason to think that bank earnings are inadequate.

The CHAIRMAN. The quotations on bank stock, though, are not very often trade on the exchange. The over-the-counter quotations are pretty high, are they not?

Mr. SMITH. Yes. One has to take account of the differences in risk between different kinds of businesses.

The CHAIRMAN. Is it not true that risk has been diminished by the guarantee of bank deposits up to $10,000?

Mr. SMITH. Right. But this is a subject that requires considerable study, because there are substantial differences among different classes of banks.

The CHAIRMAN. What about the double liability which existed prior to 1933—I think it was?

Mr. SMITH. Of course, that has been eliminated.

The CHAIRMAN. Yes. Therefore, in comparison with the 1920's the risk is less, is it not?

Mr. SMITH. Yes.

The CHAIRMAN So that the risk since 30 years ago has been reduced in two significant respects: The guarantee of the first $10,000 of bank deposits, and the removal of double liability.

Mr. SMITH. That is right.

Representative KILBURN. Would the chairman yield?

The CHAIRMAN. Surely, Clarence.

Representative KILBURN. This is a pretty high level to me, but if I understand you correctly, the FDIC, of course, does not protect the stockholder; it protects depositors.

The CHAIRMAN. But in protecting the depositors, it reduces the potential liability of the stockholders.

Representative KILBURN. There is no double liability, it is correct——

The CHAIRMAN. There may not even be single liability.

Representative KILBURN. But if the bank fails, the stockholder is wiped out.

Mr. SMITH. May I remark that the FDIC has conceived its responsibility to be to prevent bank failures, rather than to bail out depositors after the bank has failed.

Representative CURTIS. It is insurance; the member banks pay a premium.

Mr. SMITH. Right. But the FDIC conceives its job as being more than sitting there, waiting for banks to fail.

The CHAIRMAN. The severe incidence of risk has been diminished.

Mr. SMITH. That is right.

The CHAIRMAN. This is a very important question, Mr. Smith. I wish you economists would put your best brains to the issues as to how this increase in credit could be effected. There are enormous sums involved. As you know, Irving Fisher, who was probably the greatest economist that this country has ever produced, advocated a hundred percent reserve system, in which the banks would issue only as much credit as the Federal Reserve held bonds, and in which the

entire profits from the creation of monetary purchasing power would go through the reserve into the Treasury, and that the banks would make their earnings then by charges for services, as the cashing of checks, and on the difference between the wholesale rate of, say, 3 or 4 percent, and the retail rate which they charged.

The Government, under the Fisher plan, is the manufacturer of monetary purchasing power, and the banks are the retailers, making their profit by commissions on checks, plus the difference between the wholesale interest rate and the retail interest rate.

Now, I want to make it clear I do not go as far as that. I am very modest, because I am not proposing, let the record show, that the reserves should go to 100 percent, although as I say, Professor Fisher, who is a conservative economist and the greatest mathematical mind that economics has ever had in this country, did go as far as that.

I am simply saying that I think that we should get at least the present commission, which is one-sixth, and this would be $11 to $12 billion.

Mr. SMITH. There is one other aspect of the thing, Mr. Chairman, which perhaps relates—faintly, at least—to the 100 percent reserve plan. Of course, people like Fisher who favor the hundred percent reserve plan, favor it for entirely different reasons from the interest saving to the Treasury; but in that connection there is another factor in this thing to be considered, and that is that lower reserve requirements do increase the leverage of the central bank in conducting monetary policy.

They can achieve a given restrictive effect with a smaller volume of open market purchases and sales, with lower reserve requirements than they can with higher reserve requirements. The advocates of the hundred percent reserve plan, by and large, do not think discretionary monetary policy works, and want to get rid of it. That is why they want a hundred percent reserve. The person who thinks it works may prefer the lower reserve requirements as a means of increasing leverage. I am merely saying that this is a consideration that has to be weighed in the balance in deciding this question as to whether reserve requirements should be raised, kept the same, or lowered.

The CHAIRMAN. I have more than used up my time.

Congressman Curtis?

Representative CURTIS. I will pass.

Representative KILBURN. I will pass, too, Mr. Chairman.

Representative PATMAN. Concerning bank earnings, I was told the other day by a person in whom I have confidence that the banks' earnings are 109 percent more than 7 years ago. Does that strike you as being excessive, or about right, or low?

Mr. SMITH. I do not have the figures in front of me. I would want to know one thing, the size of the capital investment in the banking system, and what rates of return the banks are earning.

Representative PATMAN. Do you have that for us?

Mr. SMITH. I do not have it here.

Representative PATMAN. I will not pursue that, then.

The banks are selling their Government bonds now to some extent for the purpose of expanding loans?

Mr. SMITH. That is right.

Representative PATMAN. Last year, I believe, they sold about $5 or $6 billion.

Mr. SMITH. $8 billion, or more precisely $7.8 billion.

Representative PATMAN. Of course, those sales eventually become reserves, do they not, in the banking system?

Mr. SMITH. Well, when the bank sells Government securities and a depositor somewhere in the banking system pays for them, what happens is that a deposit somewhere in the banking system is liquidated, which sets free some reserves, thus permitting the banking system to expand as much, assuming reserve requirements are the same for all banks, as the amount of deposits that were killed off by the security sale.

Representative PATMAN. It occurs to me that the proof is rather abundant that higher interest does not necessarily induce more personal savings. Is that a correct assumption?

Mr. SMITH. I think there is no evidence to the effect that rising interest rates induce more saving.

Representative PATMAN. Well, is the evidence not just the other way?

Mr. SMITH. I think there is little evidence of a relationship between the interest rate and the rate of saving in either direction. One could argue either way.

Representative PATMAN. Yes, sir.

Mr. SMITH. If people save for earnings, they may save more at higher interest rates. If they save to achieve a given retirement income, they may save less at higher interest rates, because they don't need to accumulate as large a capital sum to yield the income they want.

Representative PATMAN. But if you take the available information of the last 10 years, I think you will find that there were more savings when interest rates were low than when interest rates were high?

Mr. SMITH. I doubt if the relationship is clear-cut. The thing is that there are a lot of other things that affect saving behavior besides interest rates, if they have any effect.

Representative PATMAN. Of course, as to that word "clear-cut"—I got this from a Federal Reserve Bulletin, this recent one, January 1960. The savings percentage of the gross national savings of gross national product in 1954 was 22.3; in 1955, 25.6; in 1956, 26.0; in 1957, 24.9; 1958, 21.2; 1959, 9 months' average, 24.9.

I think, to go back and take the Federal Reserve Bulletin as evidence, that you will find that savings happened to be higher when interest rates were lower.

Mr. SMITH. Well, that may be true to some extent. I really think there is no evidence, however, of any systematic sort that there is a significant relation between the level of saving and the rate of interest. I might say, however, that there is some indication that the composition of saving is affected by relative interest rates on different kinds of claims that people might invest their savings in.

Representative PATMAN. Is a higher interest rate a deterrent to economic growth?

Mr. SMITH. It certainly tends to reduce the level of investment.

Representative PATMAN. That is particularly true in housing and things like that, I assume.

Mr. SMITH. It is certainly truer, largely for institutional reasons, in housing today than it is anywhere else.

Representative PATMAN. I agree with you.

Mr. SMITH. However, there is little question that a higher interest rate tends to discourage most kinds of expenditure on capital equipment, and so on, although again, as in the case of saving, most of the evidence suggests that the relationship between the level of expenditures and the interest rate is not terribly strong.

Representative PATMAN. Mr. Gainsbrugh the other day had a very rosy picture of the outlook for 1960, and I asked him if he would change his predictions if interest rates had a substantial increase, and he said he would not.

I did not pursue that further, because I was interrogating another witness at the time and I did not get back to him. But I assume that he based that upon the fact that in capital expenditures, most of the people involved, of course, get a tax deduction on their interest, and a 6 percent rate becomes, in effect, less than a 3 percent rate to them; does it not?

Mr. SMITH. Well, that is not quite as simple as it appears to be, because the tax applies to the income on the investment as well as to the interest, so it affects both sides of the calculation.

Representative PATMAN. That is right.

Mr. SMITH. I read Mr. Gainsbrugh's paper, and I certainly would be strongly inclined to agree with him on this point, because for one thing, he was talking about business plant and equipment spending, and inventory investment.

Representative PATMAN. That is right.

Mr. SMITH. As he pointed out, next year—this is generally true, but particularly for this coming year—it is very likely that almost all of the plant and equipment expenditures of corporations will be financed out of internal funds: depreciation allowances, retained profits, and accumulated liquid assets. They are not going to have to go out and borrow.

Representative PATMAN. Which a great industrialist referred to one time, I think accidentally, before this committee, as "costless capital," an internal fund.

Mr. SMITH. It is really not costless if they make careful calculations, but it seems they don't consider the alternative opportunities for investing these funds outside the business very much, and the funds are in a sense treated as if they were costless capital.

Representative PATMAN. If prices were to increase substantially, that would have an effect, be a deterrent to capital expenditures, would it not?

Mr. SMITH. It depends on what interpretation is placed on the price increase. If the price increase is interpreted as reflecting a future continuation of rising prices and profits, it may stimulate investment.

Representative PATMAN. Yes, sir. I believe you brought out the fact that rising interest rates, of course, hurt the ability of State and municipal governments to finance public facilities, such as schools and highways. I think that is a good point, too.

And your summary there, I think was real good:

> It appears that we are running the risk of locking the economy in a tight credit squeeze which will hold back economic expansion and growth without dealing effectively with the inflation it is designed to check.

I do not know of any American citizens who believes in inflation. I do not think that there is a Member of Congress who is in favor of inflation. We are against inflation, and at the same time we are for economic growth. But I have a difference with the Federal Reserve Board, in that they are using the wrong weapons and devices and vehicles to prevent inflation; in other words, they are using the weapons that will increase interest rates and hurt the people generally, when they could use other weapons and hold down interest rates and prevent inflation just as effectively as the weapons they use.

I refer to the fact that they have invariably reduced reserve requirements, like Chairman Douglas has brought out, to give the banks more power to expand, and they have never in recent years raised reserve requirements of banks. I think they could use that method, of raising reserve requirements of banks, and I think they could use open market operations. I think they could even immobilize reserves. They have complete power and many weapons. Do you now agree they have many weapons they are not using?

Mr. SMITH. No, not entirely. They do not use reserve requirement changes. But I tend to agree with them that for tightening credit in cyclical situations, the reserve requirement is a clumsy weapon, and I do not agree that as between the different weapons of general credit control that they now have, there is an appreciable difference in terms of the effect on interest rates. I think interest rates are going to go up about the same amount, whether you tighten credit by changing reserve requirements, by open market sales, or by adjusting the discount rate.

Representative PATMAN. That being true, we should adopt the chairman's suggestion that we let these bonds be bought by the Federal Reserve, the Open Market Committee, and then let the interest on those bonds, as paid by the taxpayers, flow over into the Treasury, 90 percent; and of course the other 10 percent belongs to the Government; it is just temporarily withheld.

Mr. SMITH. It is true that will save the Treasury some interest money. But it will not tend to keep interest rates, in general, lower.

Representative PATMAN. I want to ask you a question about a proposal to cancel $15 billion of the Federal Reserve securities held by the Open Market Committee. Have you studied that proposal, Mr. Smith?

Mr. SMITH. I have not studied it, but I will make a stab at commenting on it.

Representative PATMAN. Of course, whenever the Federal Reserve buys these securities, it uses Government money, and based upon the theory that if you use your money to pay a mortgage that you owe, that mortgage should be canceled. Applying that principle to Government, which uses its own money to pay its bonds, then the bonds that are so paid are eligible for cancellation.

I recognize that it must have a certain amount of flexibility in adjusting monetary policy. But now that the Federal has $27 billion of Government securities that it has acquired by trading one form of Government obligation for another form of Government obligation, it is proposed that we cancel $15 billion of that.

Of course, if we just literally canceled it, we would have problems, many problems that would be difficult to handle. But the proposal is that we have the Treasury deliver to the Federal Reserve Open Market

Committee, or to the Federal Reserve banks in proportion to their ownership in the portfolio, non-interest-bearing obligations to the Treasury, payable upon demand, on the theory that the Treasury would never be called upon, you cannot conceive of a situation that would require the Federal Reserve banks to call upon the Treasury to pay those demand obligations; and in that way you would reduce the national debt limit $15 billion.

As you know better than I do, non-interest-bearing obligations such as Federal Reserve notes, for instance, are not carried as being necessary to account for in the national debt limit. Therefore, you would reduce the national debt by $15 billion immediately, which would solve a lot of our problems, and would at the same time save the taxpayers the interest on that $15 billion.

What do you think about that, Dr. Smith?

Mr. SMITH. I have two or three things to say about it. In the first place, it seems to me that the national debt, properly speaking, should not be thought of as including securities held in the Federal Reserve banks anyway, because these securities are essentially held inside the Government, and most of the interest on them goes back into the Treasury.

Representative PATMAN. I want you to say that again. You are talking about $27 billion, are you not?

Mr. SMITH. That is right.

Representative PATMAN. I wish you would say that again.

Mr. SMITH. Well, I regard the Federal Reserve System as essentially part of the Government, and the Federal Reserve is subject to a 90-percent marginal tax rate—in fact, this last year it has subjected itself to an even higher rate, and you can subject it to a still higher rate if you want to.

Representative PATMAN. It is important that we get our definitions straight on that, if you please.

Of course, all that money belongs to the Government. They just voluntarily turned over 90 percent at the time. The remaining 10 percent which is in a surplus fund belongs to the Government, it is just withheld, and last year they turned over $266 million voluntarily, in order to help the administration balance the budget. Out of that surplus fund has been retained the 10 percent.

Mr. SMITH. What I mean is that it seems to me that from the point of view of saving interest, the cancellation process is largely a bookkeeping operation; it is not going to have very much effect on the Treasury's interest costs. And as far as the debt limit is concerned, I just happened to think that the debt limit should be eliminated anyhow and that if you want to deal with the debt limit, why not just deal directly with it, rather than trying to get out from under it by canceling some securities held by the Federal Reserve?

Representative PATMAN. Do you not think there is merit in that proposal, Dr. Smith? Even if it is not proposed exactly like you would like to have it done, do you not think it has the makings whereby a good economist like yourself can work out a plan that will enable the Government to cancel that $15 billion?

Mr. SMITH. I must say I cannot see any harm in it.

Representative PATMAN. Nobody would be hurt.

Mr. SMITH. Perhaps it would be desirable if an arrangement were made so that the Federal Reserve could swap securities with the Treasury in such a way as to get the kind of securities it needs to conduct open market operations, and your proposal might facilitate doing that. The System now has let its portfolio get very short in composition, so that in some cases it is not in a very good position to conduct open market operations in longer term securities anyway, and I think there would be something to be said for an arrangement that would permit the System to get the kind of securities from the Treasury it needs for open market operations purposes.

Representative PATMAN. You brought out a point there I shall mention and then yield to other members. I do not want to take up too much time here.

But you mentioned about the Federal Reserve being unable to make frequent transactions. Of course, there is one exception, which I am sure you know about.

However, we have a situation as if 17 dealers had tollgates set up in New York City; 17 tollgates, 17 dealers; and all these bonds must go back and through, back and forth through one of these 17 dealers, these tollgates. If they could deal directly with the Treasury, enormous sums of money would be saved which would be reflected in the debts of the Nation and be helpful to the taxpayers.

Do you now agree with that?

Mr. SMITH. Well, there are some problems about that. You want to affect the market. I am not trying to defend the dealer mechanism entirely, but when you deal through the dealer mechanism, the impact is felt by the credit market. The Federal Reserve doesn't just buy Government securities to get them, it buys them for the purpose of achieving effects in the market. These effects would not be achieved if it merely changed its portfolio through dealings with the Treasury.

Representative PATMAN. Well, they are channeled in this case, channeled through. They cannot go directly at all, and save enormous sums of money that way. They have to go through these private dealers. I think that this committee should give further consideration to it.

The CHAIRMAN. Congressman Kilburn?

Representative KILBURN. There is just one short question I would like to ask.

I have always supposed that the law of supply and demand had a great impact on money rates, just the same as it has on everything else.

Do you think, sir, that the high money rate the country has now is due largely or to some extent to the law of supply and demand?

Mr. SMITH. Of course, it is due to the law of supply and demand but we have set up the Federal Reserve System as a central bank, and one of its functions is to constitute part of the supply and demand for funds.

Representative KILBURN. That is right.

Mr. SMITH. And by shifting the supply and demand for funds in appropriate ways, to achieve desired effects on interest rates. The Federal Reserve cannot say the interest rate is high because the supply and demand make it that way and escape responsibility for it.

Representative KILBURN. No; they have some responsibility. I understand that. But my point is that a great many times you hear people say, "Well, the Federal Reserve can set any interest rate they want." I do not think they can. I think they have to follow the market to some extent.

Mr. SMITH. Perhaps the Federal Reserve cannot set any level of rates it wants, but it can certainly manipulate the level over a reasonable range. I am not saying it should keep rates low, but the Federal Reserve tends to understate its impact on interest rates in some of the statements it makes. It has a good deal to do with the level and structure of interest rates, and should.

The CHAIRMAN. I think, since the chairman and the vice chairman have consumed a good deal of time in questioning, we should let Congressman Curtis do his questioning now.

Representative CURTIS. Thank you, Mr. Chairman.

First, I want to say to Dr. Smith how much I appreciated his paper, just as I want to say that the chapter you prepared in the staff report, I thought, was excellent.

Mr. SMITH. Thank you.

Representative CURTIS. Much as I disagree with many of the conclusions that come out of it, it is in my judgment so well presented that one can follow the areas where one might disagree. It is a scholarly job, and I always have found that to be so.

One question I would like to ask was brought out by, I think, Mr. Reierson the other day on this question of, What is money today? So much discussion has been in terms of money supply, and he was raising the question, as I understood it, of whether our definitions today of money supply were really descriptive of what amounts to money in our society. Would you comment on that?

Mr. SMITH. Surely.

I think there is an awful lot of semantics involved in this question of how you define the money supply. I personally prefer a narrow definition which confines it to actual means of payment; that is, the things people use to settle transactions with, which means demand deposits and currency. When you use a narrow definition of that kind, you cannot on that account overlook the importance of time deposits, Treasury bills, and all kinds of claims which have a relatively high degree of liquidity and are good substitutes for money.

Somehow, I have always found it makes for more clarity in analysis to restrict the definition of money to the narrow one, and then allow for the effects of these other things on the turnover or velocity or rate of use of the money supply, narrowly defined. You can come to the same answers, using that definition, as by putting some of these things into money supply. Personally, I think it frequently muddies the water to put Treasury bills and time deposits and a lot of other things into the money supply.

Representative CURTIS. I think I have got a phrase, then—you used the expression "substitutes for money"—to ask this question: Do you feel that the substitutes for money have been increasing, both in variety and in amount?

Mr. SMITH. You mean over, say, the postwar period?

Representative CURTIS. Yes, the postwar period. In other words, it seems to me that many substitutes for money have come into the picture and are playing a more important part than before.

Mr. SMITH. That is right. For example, the public debt has shortened substantially in composition, and there has been a tremendous growth in savings and loan shares and time deposits, and things like that, which are close substitutes for money.

Representative CURTIS. I have often speculated as to consumer credit. Is there not a great deal of savings in consumer credit, real savings?

Mr. SMITH. You mean in the form of durable goods?

Representative CURTIS. That is right, in that form, particularly in the housing field, whether that is called consumer credit or mortgage.

Mr. SMITH. Well, housing and other consumer durables are treated differently in national income accounts: That is, housing is treated as a consumer asset and included in savings, whereas durable goods like automobiles are not.

Representative CURTIS. That is right; they are not.

Mr. SMITH. There is a question here as to what the proper definition of consumer assets is. There is something to be said for including consumer durable goods in savings for some purposes, while excluding them for other purposes.

Representative CURTIS. Some aspects of it are. Life insurance policies, of course, are included, I guess, as actual savings, though I have often wondered whether we actually measure the amount of savings in them accurately.

Do they use cash-in values on those. by the way? I am not thinking of term insurance, but the ordinary life insurance.

Mr. SMITH. It is the accumulated equity of the consumers in life insurance policies over and above the pure insurance involved. That is, to the extent you buy insurance other than term insurance, there is an element of saving in it, and the national accounts attempt to measure that and rule out the payments for insurance proper, which are included in consumption expenditures.

Representative CURTIS. At the end of your paper you say:

> In fact, it is probably impossible to deal effectively with the kind of inflationary problem we are faced with by means of the tools presently at our disposal.

What means would you suggest be at our disposal? Standby controls? Or do you have something else in mind?

Mr. SMITH. I would favor some effort to make more use of selective controls, although I am quite aware of the fact that selective controls pose some difficult administrative problems. I think the Federal Reserve should have at least standby controls over consumer credit.

Representative CURTIS. Is that the extent of what you thought——

Mr. SMITH. I think personally we are in a real dilemma on this inflation problem. I am not sure that we have effective means to control the kind of inflation we have been having. In principle, we could control it with a battery of highly complicated selective controls. But there are two problems: One is that it is extremely difficult to administer a complicated battery of selective controls, and the other is that if we did succeed in controlling the kind of inflation I think we have had that way, we would tend to immobilize the price mechanism, which serves the function of allocating resources. The

problem seems to be mainly that when we hit somewhere, except a few sectors where prices are flexible, we tend to drive down the output and employment in that sector and only affect the price level through the indirect effects of falling incomes and reduced consumer spending in that sector.

This means, if it is true and our inflation is of the sectoral sort, that the only way we can control it by monetary or fiscal means is to hit the sectors where the inflation is. On the other hand, this inflation, which arises out of shifts in demand, tends to produce rising prices in the sectors where demand is expanding, thus serving the function of attracting resources there.

Representative CURTIS. One of the reasons why I am reluctant even to see standby controls is, we should wait until we get a better understanding of what this increased price is. We keep referring to it as inflation, and I suspect in many instances it is actually increased cost and we are just not willing to recognize it.

I notice in your paper you say:

> The prices of services, such as medical care, have risen steadily in recent years, and the rise is likely to continue.

I am satisfied that a real analysis of medical prices will show that we are talking about real costs.

Mr. SMITH. What you are saying is that you think the price indexes contain a considerable amount of upward bias, resulting from the fact that we have quality improvements.

Representative CURTIS. That is right.

Mr. SMITH. And I quite agree with you.

Representative CURTIS. And it gets really down with some very real costs.

I also happen to think this is true: That as we have rapid technological advancement in any selected field, medical or whatever it may be, we are going to have increased costs. We have to absorb our research and development, which tends to bring it about; we have obsolescence to pay for, obsolescent skills as well as equipment and machinery, plus the new equipment that we buy. The old equipment does not wear out: it is replaced because of obsolescence. And all of that seems to me to be real economic costs.

We can relate that—and I am going to get over to this growth area, if I may—to the agricultural sector, where we likewise have had very rapid technological advancement, as in the medical field, and I suspect that a good bit of the items in that area are cost items.

The question I was wondering about is whether you think we really can grow, I mean have a sustained growth that is faster than certain checkpoints like, say, savings, real savings that we actually accumulate. Can we really have sustainable growth that exceeds that?

Mr. SMITH. I think we can to some extent regulate the volume of saving.

Representative CURTIS. How could you do that? In World War II, of course we did.

Mr. SMITH. We can have saving through the Government.

Representative CURTIS. How can the Government save? I don't understand that.

Mr. SMITH. Through budget surpluses.

51708—60——16

Representative CURTIS. Well, I do not regard that as savings in the sense I am thinking about. Certainly, by having Government surpluses, which I certainly want to see, and I want to see more of them than we have right now, certainly, in these periods; but actually that is simply releasing savings, other savings that have already existed. That is releasing those savings to the private sector so that they can be utilized there. It is not any new savings.

Mr. SMITH. What I mean is that we may, for example, by raising taxes, reduce consumption and achieve additional saving through the budget.

Representative CURTIS. I see what you mean. You would regard taxes in the same nature as forced savings.

Mr. SMITH. Our monetary and fiscal policy has something to do with our rate of growth. If we have a tighter fiscal policy and an easier monetary policy, we can get some mileage—I think it is limited—in the direction of increasing growth.

Representative CURTIS. Yes; I see your point.

Mr. SMITH. A more important point is that the Government do everything it can to encourage innovation and research and development. As a matter of fact, I think it is very important for growth that everything possible be done to encourage fundamental research. The Government could do a great deal more in this area than it has been doing.

Representative CURTIS. I suspect that the Government has probably been damaging, by its activity, real research and development, in many instances. I think we have to be very careful, in coming in in the guise of stimulating research and development, that we do not actually stunt it. I suspect the real development in this country is still going to come from the private sector, through whatever motivates human beings in this society, a free society, rather than from some bureaucrats deciding that in some particular area we need more research and development.

I frankly do not think bureaucrats or any group of people know that much, to be able to decide just where we need to do research and development.

Mr. SMITH. I agree with you that you have to be careful in something like this. But I still think there is a great deal that the Government can do to encourage technological progress and research and development.

Representative CURTIS. I would like to see us review what we are doing, review our patent laws and our tax laws and so forth, and see whether or not they are up to date and whether or not we are really interfering instead of encouraging growth. I think there are many, many ways in which Government action is actually destroying and damaging, rather than helping, and I am very concerned about recommendations that the Government do more in this field.

The CHAIRMAN. I feel, in a sense, we owe you both an apology for taking so much time.

I think perhaps the best thing to do would be to have Mr. Musgrave go on with his paper.

STATEMENT OF RICHARD A. MUSGRAVE, THE JOHNS HOPKINS UNIVERSITY

Mr. MUSGRAVE. I have been asked to discuss the President's recommendations on fiscal policy contained in the budget message and the Economic Report. This calls for an appraisal of the expenditure and revenue recommendations in the budget and of their relation to stabilization policy.

EXPENDITURE ASPECTS

The proposed budget for the fiscal year 1961 provides for a level of expenditures slightly above that for 1960. As has become customary, this increase is blamed in considerable part on the so-called uncontrollable items, a form of apologetics which I find most unconvincing, unless supported by legislative recommendations to curtail the particular programs which give rise to the outlay.

There are few such recommendations and in all there is little evidence of exerted effort to economise by revising old programs. Nor is there much evidence to face up to the need for new programs. Total expenditures for national security are about unchanged, as is the allocation by the various services.

At the same time, there are significant changes in composition, involving reduction in aircraft procurement, without an offsetting change in outlays for missiles. Expenditures for the space program are up by $300 million, a significant percentage increase but still a small amount in the total picture. Provision for civil defense remains at a token level. Water resource programs are expanded, and I am pleased to note a move toward restoring earlier slashes in the resources available to the Bureau of Internal Revenue.

Outlays under the defense education program are up somewhat and a modest loan program for Federal aid to school construction is recommended, but in a form which keeps it outside the budget. There is much said in the Economic Report about the need for looking upon economic progress as a joint venture in public and private effort, but there is little evidence in the budget of enthusiasm for the assumption of new governmental functions, and the administration takes much pride in having held the line.

The adequacy of these programs is a matter of considerable debate. Personally, I feel most uneasy about the limitations on our security program, placed by a policy of not exceeding last year's expenditure levels; and I do not feel satisfied at all that everything is done, budgetwise, to wipe out our second-rate showing in space exploration.

I have no claim, as an economist, for expert judgment on these matters, and this I want to make very clear, but an appraisal of the budget is not possible without speaking out on these crucial points. I feel more certain of my position when it comes to outlays on education, where the proposed program appears to fall substantially short of what is needed to maintain our leadership in the free world and where a desire to keep the program outside the budget has resulted in what seems to me a rather awkward approach to the problem.

To be sure, budgeting is a continuous process and not too much should be expected from provisions in any one year. However, the trend is important and I find it disconcerting to note that the level

of Federal services to the civilian economy should have risen by only one-third since 1950, while private consumption gained by 75 percent.[1]

However this may be, the administration's case for holding the expenditure line is not made clearly, and perhaps not even primarily, by judging the merits of the programs, although of course these are considered. Rather, it is held that utmost frugality in public expenditure is required to check inflation. Checking inflation, it is held, demands a surplus; and by deducting the required surplus from the revenue to be derived from present rates of tax, the permissible limit of expenditure is determined.

While this reasoning is not spelled out in so many words, it nevertheless suggests the spirit of the program. I do not follow this argument. If a higher level of public services along certain lines should be justified, and granting the assumption that a surplus is desirable to check inflation, the conclusion is simply that a higher level of taxation is required.

This option does not arise in the fiscal thinking of the Budget or the Economic Report since it is felt that such a course would threaten the health of our economy. Indeed, a tax cut in the foreseeable future is considered an urgent economic necessity. This, I maintain, is wrong. I continue to feel that our public policy, and as a result our place in the world picture, has suffered severely over the years by accepting this fictitious proposition.

REVENUE ASPECTS

On the revenue side of the picture, the President's major recommendation is that the temporary rates of corporation and excise tax be extended for another year. I fully concur with this suggestion. If the level of expenditures will be as recommended, and excluding unforeseen turns in economic conditions, a modest surplus will be in order.

If expenditures prove higher, there would be the more reason for maintaining present rates. In the longer run, the revenue potential or present tax rates may well outgrow expenditure requirements, but at this time, rate reduction would surely be premature. As revenue continues to grow, we shall then have to decide to what extent the gain is needed to meet growing needs for public services, and to what extent it can be used for rate reduction.

Among other revenue recommendations, the President recommends an increase in postal rates to provide for an additional $500 million with which to close the postal deficit. I am in full sympathy with the objective of placing postal services on a self-sustaining basis, but I see little gain in doing so by raising rates on first-class mail.

Since the deficit reflects largely an excess of cost over revenue in the handling of second- and third-class mail, this would merely shift the cost of subsidy from the general taxpayer to the user of first-class mail, leaving us no better off from the point of view of proper pricing than we are now. I would urge, therefore, that an increase in other rates be substituted.

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[1] In drawing this comparison, I am referring to budget expenditures other than those on national security, international affairs, veterans' programs, and interest.

A further revenue recommendation is for an increase in the highway fuel tax to 4½ percent, so that the diversion of excess taxes may be repealed and the highway program be permitted to proceed at a faster rate. Now that the highway program is under way in its present form, these recommendations seem reasonable, although the need for accelerating the program does not quite square with the need for budget surplus.

In all, the idea to let highway users pay for highway services is sound enough, but I am less than enthusiastic about the program as a whole. I am fearful that the availability of earmarked revenue sources leads us to distort our sense of priority in expenditure needs and to neglect more important functions which will require finance from the general budget.

Finally, the budget message contains certain limited recommendations for improvement of the tax system, but it fails to face the broad issues of income tax erosion and tax reform, which have been discussed in the recent hearings of the Committee on Ways and Means. It is disappointing that the budget message failed to give stronger support to tackling this task in the near future, just as I was disappointed in Chairman Mills' recommendation that action be postponed for the time being.

STABILIZATION ASPECTS

I now turn to the stabilization aspects of the fiscal program. It is interesting to note that the anticipated cash surplus of $6 billion is a reflection, almost exclusively so, of increased amounts being obtained from present rates of tax. Thus estimated receipts for the fiscal year 1961 are $20 billion above the recession level of fiscal 1959, reflecting the upward phase of the built-in flexibility of the tax structure.

Also, estimated receipts for fiscal 1961 are over $14 billion above those of the preceding prosperity high of fiscal 1957, reflecting the secular growth in tax base. The coming budget thus represents the combined benefits of cyclical upswing and secular growth. This is a happy development in which we all may rejoice, and chances are that the resulting surplus may play a useful role in the coming year.

At the same time I have been disturbed by some interpretations given to the merit of this surplus. In the State of the Union message, the surplus was heralded by the President as a means of repaying a mortgage imposed on our children, and it was said that there really can be no surplus as long as the Government is in debt.

This motion of the surplus as an absolute good, and of the public debt as a terrible burden, reappears in the closing passages of the budget message. It reflects a rather outdated conception of the fiscal policy function and seems to negate the understanding which has been gained in recent decades.

But fortunately this view stands in contrast to the more carefully reasoned earlier passages of the budget message and to the discussion of fiscal policy in the Economic Report. Here it is argued that in times of prosperity "sound fiscal and economic policy requires a budget surplus to help counteract inflationary pressures, to ease conditions in capital and credit markets and to increase the supply of savings available for the productive investment so essential to continued economic growth." [2]

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[2] See budget message of the President, p. 147, and "Economic Report of the President," January 1960, p. 54.

This statement suggests an interesting change in thinking about the function of a policy of budget surplus. This function is now twofold. To the extent that taxpayment reduces expenditures of the taxpayer while debt retirement does not raise expenditures somewhere else, aggregate demand is lowered and the net effect is restrictive.

No such deflationary results occur, at least not in the short run, if the reduction in spending by the taxpayer is offset with an increase in spending induced by debt redemption. The purpose of surplus policy in this case is not to curtail demand but to redirect the use of resources. If the increase of loanable funds, through debt retirement, is taken to raise investment while the decrease in the taxpayer's spending is on consumption, there results a shift in resource use from consumption to capital formation. Interest rates are reduced and growth is speeded up. In other words, as Mr. Smith just pointed out, the budget surplus functions as a means of increasing saving.

Surplus policy, therefore, is essentially viewed as a means of generating growth. This is a significant policy concept, but note that the argument is based on two conditions. One is that the increased supply of loanable funds through debt retirement will actually lead to expanded investment for growth; and the other is that taxpayments will be drawn from consumption.

This raises the question, to what extent plant and equipment expenditure has indeed been limited by the supply of available funds, a matter which—with the exception of retained earnings—seems rather doubtful. Also, the argument has important bearings on tax structure. Thus a surplus drawn from corporation profits tax will be relatively ineffective, while a surplus drawn from consumption taxes will be most effective.

The effectiveness of the surplus will tend to be the greater, the less progressive is the tax structure, and so forth. These considerations do not necessarily point against the validity of this policy as a means of increasing growth, but it must not be overlooked that this view carries implications for tax policy which may well be in conflict with considerations of tax equity.

As I have noted previously before this committee, in my October statement, accelerating growth by increasing the rate of accumulation in the private sector is likely to be a costly affair and not to be undertaken freely without assurance that the growth in question really matters and that other avenues to growth (such as public and private research, innovations, and the development of human resources) are pushed at an adequate rate.[3]

It is interesting to note that a position rather similar to the administration's argument appears in the staff report on "Employment, Growth, and Price Levels," [4] and finds support in both the majority and minority views of the committee report. It is held that for any given level of restraint, greater use should be made of fiscal and less use of monetary restrictions. The reasoning is that greater fiscal restriction (smaller deficit or larger surplus) will be deflationary on balance, thus permitting a policy of easier money as an offset. If now we

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[3] See my testimony in "Employment, Growth, and Price Levels," "Constructive Suggestions—Price Level," Joint Economic Committee, Oct. 26, 1959, pp. 2760–2761.
[4] Op. cit., pp. 269 and 422.

assume that easier money raises investment while tighter budget curtails consumption, we have again a transfer of resources into faster growth and a lower rate of interest. The argument is similar to that of the Economic Report, except that now monetary expansion is required in addition to debt retirement.

The implications for tax policy, as noted in the staff report, are the same as before, and so is the condition that the greater monetary ease will result in capital expenditures which contribute to growth, and not in a higher level of housing or consumer credit. In all, I am left with some doubt regarding the efficacy of inducing growth by budget surplus, and I remain impressed with the cost, in terms of equity, of achieving faster growth by increased capital formation.

At the same time, I do not deny that budget policy should make its fair contribution to restriction in the boom. Indeed, I believe that throughout the cycle, more use should be made of a flexible policy of adjustments in tax rate to meet the needs of stabilization. This does not seem out of line with the Economic Report, but I disagree with the Secretary of the Treasury who stated, in his review of the budget, that recent experience demonstrated the wisdom of rejecting such tax adjustments and relying almost exclusively on the working of built-in flexibility.[5]

As I read the record of the last recession it would certainly have been a gain, seen from the vantage point of hindsight, to have reduced tax rates in the third quarter of 1957, with a subsequent increase in the last quarter of 1959. I believe that discretionary changes in fiscal policy will be necessary if we are to improve our record in stabilization policy. I am in full agreement in this respect with the conclusions of your staff report. These discretionary changes should provide for such levels of surplus or deficit, as one needed to achieve the objectives of high employment and stabilization. They should not be geared to an alleged need for reducing the level of public debt, or for satisfying Chairman Martin's criterion of symmetry in policy.

Finally, I would note that the restrictive use of tax policy is not always in restraining investment. Be it through changes in tax rate or depreciation schedules, tax policy may be used to control the level of plant and equipment expenditures, and thus influence a sector of investment activity which is relatively inaccessible to monetary controls.

Contrary to the earlier argument, this second case for greater emphasis on tax restriction is not to reduce consumption and permit higher investment. Rather, it is based on the superior effectiveness of tax restriction in curtailing investment, as a means of curtailing excess demand. It is thus primarily an argument for the use of tax policy in evening out the cycle, but in so doing it may also contribute to the case for secular growth.

In concluding, I should add a word regarding the President's recommendation to repeal the interest ceiling. I feel that this request should be granted. In supporting it, I do not argue that the Congress should stay away from problems of debt structure or that monetary policy is beyond congressional criticism, nor do I feel that short-term refunding has added greatly to the taxpayers' cost as is claimed by the administration. This is purely a short-term view

[5] See statement by Treasury Secretary Anderson at budget press conference, Jan. 18, 1960, p. 3.

and the opposite may hold in the long run. Nevertheless, the automatic shortening of the debt does constitute a problem, and the flotation of longer maturities must not be excluded.

I do not interpret removal of the ceiling as an endorsement of monetary or debt policy in recent years and indeed I share some of the criticisms which have been raised. However, I believe that retention of the ceiling will worsen rather than improve the quality of our stabilization policy, and I am not sympathetic with the use of techniques (such as issuance at discount or exchange at par of issues currently quoted below par) which would retain the limitation while nullifying its effect. If such techniques are used, they should be chosen on their own merit but not as a means to circumvent an artificial rigidity imposed by the ceiling.

The CHAIRMAN. Thank you very much.

Congressman Bolling.

Representative BOLLING. Mr. Musgrave, you say:

> For one thing, I am convinced that more use should be made of a flexible policy of adjustments in tax rate to meet the needs of stabilization.

I would like to explore that a little. How far do you go in that? Would you be prepared to support a proposal that with certain well-defined limits the Executive have a right to trigger a tax remission which then in turn could be reimposed at varying points of the cycle, let us say?

Mr. MUSGRAVE. Yes, sir. This is precisely what I have been arguing. I feel that it is very important that we should place ourselves in a position where we can use cyclical adjustments in tax rates, be it in exemptions or in the first bracket rate. The limits for these adjustments would be defined by the Congress, and they would be used to meet the requirements of changing conditions as they may develop, much like, although not as frequently, we use changes in open market policy.

Representative BOLLING. Would you spell that out in terms of magnitude and then say why?

Mr. MUSGRAVE. As far as magnitude is concerned, suppose the Congress were to suggest that the Executive, assuming it is the Executive, could increase or reduce the first bracket rate of the personal income tax by, say up to 3 percentage points. This would then make it possible for the Executive, in addition to whatever else the Federal Reserve Board may do, to meet changes in economic conditions by raising or lowering revenue by well above $5 billion.

If an inflationary situation develops, which goes beyond what was contemplated when setting up the initial budget proposal, then there could be an increase in these tax rates. There could thereby be provided a quite substantial reduction in disposable income and reduction in consumer expenditures. The opposite could be done if you would get into a situation of recession.

Now the question arises, Why would you need this sort of thing in addition to what the Federal Reserve can do anyhow? On the recession side it may well be that such adjustments in tax rates, by releasing consumer demand, would be considerably more effective than would be easing of monetary conditions by the Federal Reserve, a policy which might not find as prompt a response in increasing investment outlays.

On the restrictive side, this procedure would be in line with letting fiscal policy share the burden of restriction more promptly.

Representative BOLLING. The implication there is that only in this fashion would you get timely action?

Mr. MUSGRAVE. Timely action of such volume. I see no reason whatsoever why we should limit ourselves to placing our entire reliance in short-run adjustments on monetary policies, because now that we have source withholding on the personal income tax, there is no question that a much more flexible tax rate policy will be technically possible.

Representative BOLLING. Would you consider this greater intrusion on the private economy than the present use of monetary policy?

Mr. MUSGRAVE. No, sir; I would not at all. I think that most likely such an adjustment in tax rates would be less discriminatory in its impact on various sectors of the economy than would be frequent adjustment in monetary policy. I see no presumption at all that this would involve greater interference.

Representative BOLLING. In your answer to my first question I led by saying "Perhaps in the hands of the Executive," and you answered by saying "If it was put in the hands of the Executive."

Have you any specific recommendation as to where this trigger place should be placed?

Mr. MUSGRAVE. I personally would be happy to see it in the hands of the Executive. I think it could be placed in the hands of the Executive without in any serious way impairing the authority and control of the Congress over tax legislation. But I fear that perhaps the Congress will be hesitant to let the Executive have this authority, in which case I would be also quite happy to give it to a body including both the Executive and a Joint Committee of Congress. This may be of minor importance, but I think that the authority really belongs in the Executive because the Executive is responsible for the conduct of stabilization policy on a day-to-day basis.

Representative BOLLING. Thank you.

What is the time problem? I have some more questions.

The CHAIRMAN. Approximately 10 minutes, but I think that all three of us have exceeded 10 minutes.

Representative BOLLING. If I have some time I would like to continue.

The CHAIRMAN. You have taken 6 minutes.

Representative BOLLING. Now, you say, "As I have noted previously before this committee, accelerating growth by increasing the rate of accumulation in the private sector is likely to be a costly affair and not to be undertaken freely without assurance that the growth in question really matters and that other avenues to growth (such as public and private research, innovations, and the development of human resources) are pushed at an adequate rate." Do I gather from that, and I remember your earlier testimony, I think, do I gather from that that you have more confidence in the growth producing effect of the investments in education and research and development than you do in the investment by the Secretary of capital goods?

Mr. MUSGRAVE. Let me answer this in two points: First, I am not as persuaded, perhaps as some other people are that we must make an

allout effort to maximize growth in general, or in the overall level of GNP. I feel that a distinction must be drawn between what previously I called relevant growth, that is to say growth which is significant for our position in the world picture and for our ability to do what we should in national security, and growth which merely adds to luxury consumption.

I do not consider it as urgent for public policy to maximize growth in general, including growth in consumer goods, which do not bear on this particular problem.

Representative BOLLING. You differentiate between the private desire sector and the public good sector?

Mr. MUSGRAVE. Yes.

And I do think that these particular public expenditures to which you refer have an especially important role to play in what I call relevant growth. Now, of course, I am also perfectly happy to see the greatest growth we can have in the private sector, if we could have it without cost. But I have been concerned with the point that getting this growth in the private sector through increased capital formation is costly. I think one should recognize, and especially people who are interested in liberal policies with regard to welfare objectives and progressive taxation should recognize, that an allout policy for growth based on increasing the rate of capital formation in the private sector may be quite costly in terms of these other objectives. Therefore, I think that in looking at the growth problem we should be very sure to emphasize that we get the kind of growth which we really need and that then we try to get this kind of growth which we really need by channels which are least in conflict with these other objectives.

Now if beyond that in order to maintain our position in the world we must do these other things, why then of course we should. But I think there is a problem of priority here.

Representative BOLLING. Implicit in what you are saying is that we presently still have the capacity if we make the right choices to meet our responsibilities without enormously increasing our rate of growth?

Mr. MUSGRAVE. I think so.

The CHAIRMAN. Representative Coffin.

Representative COFFIN. Thank you, Mr. Chairman.

Have you had an opportunity to form any tentative conclusions on the direction in which a revision of our tax system should move in order to give us a wider range of alternatives in living up to our obligations in education, security, in space exploration, and aid to developing countries, a wider range of alternatives than merely adjusting existing taxes or extending them, postal increases, and so on?

Mr. MUSGRAVE. We ought to do a thorough and extensive job in overhauling the personal income tax. This is especially important because the personal income tax should remain the mainstay of our tax structure. Today the contribution of the personal income tax to Federal receipts is higher percentagewise than you find in any of the other major countries of the world. I think this is not a shortcoming but something to be proud of.

We ought to take a good look at the personal income tax to do everything we can to improve it, to increase the sense of fairness about it. Now this involves the problems which are frequently referred to as a matter of closing loopholes. Also, it involves recognizing that

at the upper end of the scale we have perhaps gone too far with progressive rates. There is a good cause for a tax which is somewhat less progressive in rates, but is more broadly based in terms of taxable income. I would say that this is the main approach to strengthening our tax structure, our taxing capacity. I am not sympathetic to the idea of moving on to a sales-tax system, although of course a sales tax would be better than inadequate defense, certainly. But I think we can do the job with improving the personal income tax.

Representative COFFIN. On the bottom of page 7 of your statement you talk about "smaller deficit or larger surplus will not be deflationary on balance." And you have a sentence at the very bottom of the page:

> This condition may not be met in many cases, and the advantage of lower interest may be offset by the disadvantage of higher taxes.

Now is it possible to come to a firmer basis for a decision than we have now in determining policy? Is the data such that one could say, given a certain set of circumstances as to interest and taxes whether or not growth is going to be stimulated or not and whether inflation is going to be combated or aided?

Mr. MUSGRAVE. I think we can have some degree of judgment, although we do not know precisely what the effects will be. Especially, and this goes back to the point Congressman Bolling mentioned, we have to be flexible about adjusting ourselves as needs develop.

Now it may very well be that a policy of increasing the budget surplus, combined with easier money, will not lead to increased investment expenditures, that is to increased growth, but to increased expenditures on consumer durables. Or it may just be a deflationary factor, which will lead to reduced unemployment. This is one of the dangers of relaying on the growth-through-surplus policy. At other times this may not be the case. The increase in loanable funds may really flow into capital expenditures.

Conditions keep changing, and it seems to me perfectly absurd to ask the Government to set a tax policy ahead for an 18-month period in this kind of changing economy. It cannot be done any more in any sensible way as it would be for the Open Market Committee to meet and give instructions every 18 months.

Representative COFFIN. This is an interesting observation. What is the alternative? Are you suggesting a tax system where there are areas in which the Executive could move quickly without Congress?

Mr. MUSGRAVE. Yes, sir. I would suggest that Congress authorize the Executive, or not only authorize but instruct the Executive, to make movements in the first bracket rate of the personal income tax within say 3 percentage points or so, and to make such adjustments as he deems necessary in fulfilling his obligations under the Employment Act.

Representative COFFIN. Do you think this would run into a constitutional barrier? A provision of the Constitution saying that the Congress shall levy taxes?

Mr. MUSGRAVE. I think there have been other instances where authorities have been delegated by the Congress to the Executive or to other agencies to make adjustments which raise somewhat the same problem. I have discussed this with lawyers and I think it could be worked out. It would be very difficult for a congressional committee

itself to take on this responsibility because in that case you would shift one of the main aspects of stabilization policy to Congress, something which Congress really cannot do on a day-to-day basis.

Representative COFFIN. You would envisage then a congressional action delegating within fairly narrow limits——

Mr. MUSGRAVE. Subject to recall, within narrow limits, and if and when necessary this authority could be renewed. I might also say that this might help solve the problem of coordinating Federal Reserve and Executive policy. Under this scheme, both these authorities have responsibility over the current conduct of stabilization policy. This would force coordination or if there was no coordination it would make lack of coordination evident.

Representative COFFIN. How would you assure coordination if the Executive did have this power to revoke limited tax movements up or down in the first bracket?

Mr. MUSGRAVE. Well, I would say that the very fact that lack of coordination would be evident would tend to bring about greater coordination.

Representative PATMAN (presiding). Mr. Curtis.

Representative CURTIS. I am a little surprised—you did not mention one tax, unemployment insurance tax actually works that way, does it not?

Mr. MUSGRAVE. The unemployment insurance system works that way.

Representative CURTIS. The system and the tax. The tax rate of course is highest at the time of prosperity and lower in times of greater unemployment?

Mr. MUSGRAVE. Yes.

Representative CURTIS. I want to mention one detail and then some fairly broad things. This housing situation seems to me so unintentionally to have become a type of selective control that works counter cyclically, due to the impact of our interest rates on interest ceiling. I think we have to regard it that way, but we cannot have it both ways. In other words, sure, higher interest rates running up against the ceiling in times of prosperity are going to cut down housing, we are already saying that the testimony is in this period of upswing, there is a cutback, but also if that same theory applies, automatically, if we were to move into a recession where money were loosened, interest rates could go down automatically, we would have a stimulation in that area. Do you care to comment?

Mr. MUSGRAVE. There is much to be said in favor of your argument. It works that way. The difficulty may be just that the people whose construction is being postponed are the people who are most in need of the mortgages, et cetera.

Representative CURTIS. Exactly, and it so happens that that is what I argued on the floor of the House and why I was against the ceilings because of the people involved. I found myself in a strange position on the Republican side arguing that and the other side not really arguing from the standpoint of the counter cyclical effect but claiming to be helping the borrower. I do question it. That is why I question selective controls, because when we get down to who we are hitting by imposing the control it might be the people who we do not want to hit.

Mr. SMITH. I would like to made a comment on that.

Representative CURTIS. Surely.

Mr. SMITH. I have felt that the interest rate ceilings have served a useful purpose, although I must say that I am a little uncertain as to whether the labor released when the market tightens is absorbed somewhere else. In any case, I think the ceilings ought not to be taken off this sector unless they are replaced by some other kind of selective control.

Representative CURTIS. You would like to see the controls in?

Mr. SMITH. That is right.

Representative CURTIS. I think you are being very consistent.

Mr. SMITH. Under the present arrangements, the fellow who buys a house in a boom period when interest rates are high pays a lower interest rate relative to what other people are paying than does the fellow who postpones buying his house until a time when the economy benefits from the spending. I do not like this feature of the interest rate ceilings.

Representative CURTIS. I do not like it and I do not like selective controls for this very reason. Certainly, this is a happenstance that has come about in this housing field.

Now Professor—first let me say, Professor Musgrave, the same thing I said to Dr. Smith, that I always enjoy your papers and I find them extremely stimulating and always I find things that I agree with and some things that I do not agree with.

I think you are being a little bit unfair to the administration in saying these various uncontrollable items in the budget possibly are not too convincing unless supported by recommended legislation to curtail particular programs which give rise to the outlay. If you examine into the particular programs I think you will find that either the administration has made strong recommendations on things like agriculture which is one of the biggest built in, and outside the budget uncontrollable items. Whether we fully agree with their proposals for what we do in agriculture, certainly, the administration has made plenty of recommendations.

Then the Veterans' Administration programs, we just put a new one in last year or the year before. I happen to think it was probably good in the long run and would probably save money but I must say on behalf of the administration they opposed it and thought it was ill-advised. And it certainly is an expensive program incidentally. It would be silly for the Administrator to comment or recommend that a program that has been just put in ought to be repealed. But I think it proper for the administration to comment on the fact that it has been those kind of things that have been put in the budget, many of which they resisted, that they tried to stop, which are uncontrollable items.

On another item I might mention and I certainly agree with a great deal you said on the highway program, I just wish I could have gotten a little bit of support in the debate on that, because I tried to point out the dangerousness of these earmarked taxes, these separate funds, just for the very reasons you point out. But I must confess that both political parties err in that area, in my judgment.

Certainly, in 1958, an accelerated program was put in by the Congress. I was one of the few that took the floor to oppose it. It broke down even the trust fund theory so the highway program became another one of these open end type operations.

I was trying to follow your reasoning in regard to your saying, "If a higher level of public services along certain lines should be justified, and granting the assumption that a surplus is desirable to check inflation, the conclusion is simply that a higher level of taxation is required," and I commend you for that point of view.

Too often these people who want to spend more money are the very ones that do not want to increase taxes. But the question I have is that many people and I am one of them believe that our level of taxation now is undermining the economy. What do you think about that? Do you think that we actually can stand a higher rate of taxation than we presently have without damaging the economy, the very things that we are seeking to promote?

Mr. MUSGRAVE. First, let me say again, that I have no expert judgment on whether the security program or the space program has been unduly limited. If I think so, I am just speaking as a citizen, not as a technical expert. However, I am convinced that we should not permit our judgment on this to be affected by a fear that our economy cannot carry the tax burden. I do not believe that the present level of taxation, especially if appropriate adjustments are made in the tax structure, is a serious impediment to a healthy and prosperous economy.

Representative CURTIS. If you believe that the tax rate itself was so high that it was stunting this growth in the structure of our society, you would recognize, would you not——

Mr. MUSGRAVE. It would enter; yes, sir, and it would be fine if the resources that have to be used for defense could be available for more pleasant uses. But I simply do not believe that we cannot have a prosperous and expanded economy with, generally speaking, present or even somewhat higher levels of tax rates.

Experience simply belies this. I really do not believe that we are up against this limitation. Protestations not to the contrary, there is a real problem. A feeling that taxes cannot be raised, or that they must be cut, has been entering the administration's thinking on what can be done in defense, what can be done in space, what can we afford to do. I think this is simply not a valid argument, and that if we reason this way, a very serious mistake is made.

I am not saying we cannot improve our tax structure. And I am not saying that I really know how much additional services are needed. But I can say, as an economist, that our economy can be prosperous and growing with the general level of tax rates which we have now.

Representative CURTIS. Well, that is what I question. And I am trying to talk from an economic standpoint. I question whether our tax structure, even at this high level, even granting a lot of reforms, can be sustained. The Government is doing so much in its segment which is removed from the tax base, I find there are many people who share that concern.

I might say to point to a specific thing, the very demands to increase the number of people in the Bureau of Internal Revenue to try to collect the taxes, and it is a greater increase than just a proportionate one to taxes to be collected, is an indication that we are meeting resistance. Our tax structure, our collection system is essentially a voluntary one.

People laugh when we say that but it essentially is. But when taxes get to a certain point we find a surge of resistance and there are various ways devised of getting around paying. I myself am convinced that solely from an economic standpoint and the job of collecting taxes we have reached the point where we have to do something in this area. For that reason I question whether we can solve our problems by increasing taxes.

I might agree that if we are confronted with a situation in which a question of spending the necessary amount for defense is necessary then the only way we can get money is to increase taxes. I think we could absorb that for a short period of time if the public understood it. But it is a very difficult problem and for that reason I think that the administration's position is perfectly sound. Where you disagree with them is in the area of the tax structure.

I want to go on to say that I happen to agree with your criticism of the administration in not proposing tax reform. If that is true, and that is your argument, then a great deal more ought to be done toward making recommendations for revising our tax structure and getting it set up on a basis where it is more efficient. I too was disappointed that the administration did not say more and that the Ways and Means Committee went through all this motion and then said, "We are not going to do anything further about it in 1960."

You make some criticism of the President's referral in his state of the Union message that we are passing on a mortgage imposed on our children, and then you go on to relate how you are happy that people today have abandoned the notion of the surplus as an absolute good.

I think you predicate that on the assumption that everyone agrees that we need to have a Federal debt, that there must be a Federal debt. Now granted that is somewhat academic because we are going to have one for the foreseeable future, but I think there are many people, and I am one of them, who feel that the Federal debt, in good economics, ought to be considerably lower, a considerably less percentage of the gross national product than it is now. I think your thesis is made on the assumption that we are going to continue to keep the debt this high and that when we go into a recession all right, we have deficit spending and when we come out we pay for those deficits. There are those like myself who think we ought to be gaining on this thing a little bit.

I don't know what we ultimately might get down to on percentage. I do not know enough about it. But I do have a feeling that at least for the next decade or so it would be very good to have surpluses that are a little bit greater than the deficits that we may incur as we have these future recessions.

But do you not recognize that as a respectable theory?

Mr. MUSGRAVE. I feel that if we discuss this long enough we could probably get together on the point. The debt which we have now is of course overwhelmingly the result of war finance.

Representative CURTIS. That is true, yes.

Mr. MUSGRAVE. The amount of debt which did not originate in war finance is quite an insignificant part of the total. Now obviously we would be better off today if we had not had the war, and if we had not had the war debt. There is no question about that. But

the point is we have the war debt. And the question is whether this debt is such a problem that it is necessary to do something about it.

The first point to note is that the magnitude of the debt problem is shrinking rapidly, due to the growth of our economy.

Representative CURTIS. You mean in relation to gross national product? I do not think it——

Mr. MUSGRAVE. In 1945 the ratio of publicly held Federal debt to gross national product was 97 percent. In 1960 it is about 40 percent. This is below the level of 43 percent in 1939.

Representative CURTIS. Do you not think—let me interrupt—do you not think to get the real economic picture we have to include both Federal, State, and local debt, because it is the total in all governmental sectors? Because we can shift, as we did shift during the war period, from State and local expenditures to Federal. We had to. And then when the war was over there was some shift back again. So do you think it should be the total governmental debt in relation to GNP to make it meaningful from an economic standpoint?

Mr. MUSGRAVE. I would say the State and local debt is a somewhat different problem. It falls somewhere between Federal and private debt. But the ratio would have gone down.

Representative CURTIS. That is the point.

Mr. MUSGRAVE. Even if all public debt is included, and it will continue to fall as gross national product rises. The ratio which I mentioned will be down to about 27 percent or so by 1970. Whether we should add to the debt or whether we should reduce it, should be determined at any time in line with what is needed to achieving our objectives of a healthy economy, including high employment growth, stable price levels, and growth. It follows from the requirements of stabilization. The level of the debt as such is not sufficiently important, and a policy of reducing it at the cost of sacrificing the basic objectives of stabilization cannot be defended as a sensible policy.

Representative CURTIS. I think it ought to be an item in there. You can vary the amount but I think it should be an item in this whole complex.

Mr. MUSGRAVE. But then it enters as an aid to growth. This is the line of reasoning in the Economic Report. We should have a contribution to growth through the saving from budget surplus, which involves retirement of public debt. This debt retirement, however, is really incidental because we could have the same result by withholding the surplus and increasing the money supply. This is a position about which I have some qualification, but which certainly makes sense. However, it differs from the way in which the President referred to the debt problem in the state of the Union message. In contrast to the way in which the thing is discussed in the Economic Report, this was just rattling a skeleton.

Representative CURTIS. I do not agree. I think the two are entirely consistent. It is true that we pass on this sizable debt, without reduction, and you have pointed out and rightly so that we have cut that down some, but any passing on of that debt to the next decades is passing it on to our children.

You may argue that for other reasons that are compelling that we cannot avoid doing it. But I think it consistent with the statement in the Economic Report of the President.

Mr. MUSGRAVE. We pass it on to our children in the sense that by having a surplus policy now we could have faster growth, which would leave our children with a larger gross national product. This holds only to the extent that the policy of speeding up growth through surplus is really feasible.

Representative CURTIS. You are arguing, in effect, that releasing money through reducing the debt is not consistent with price stability and growth. I think it is entirely consistent. Let us put it this way: It can be. I can see where you argue whether we can do it this year or next year or how much this time. But I certainly think it can be completely consistent and can be a component.

Mr. MUSGRAVE. Depending on what economic conditions will be. It may prove consistent or it may not. I say we should reduce the debt only if it is consistent with the other objectives of stabilization.

Representative CURTIS. You were saying it was almost per se inconsistent. I was objecting to that. I do not think it inconsistent. I think it entirely feasible and I hope we can follow a policy like that and I am one who recognizes that in a recession period it is probably wise to have some deficit——

Mr. MUSGRAVE. This is the main point on which we have to agree.

The CHAIRMAN. Congressman Patman.

Representative PATMAN. Professor, I like your statement about giving the Executive more flexibility and making it possible to have additional revenue to carry out the objectives of the Employment Act. I assume that you would expand that to include the balancing of the budget too, and maybe make a substantial payment on the national debt when times are good?

Mr. MUSGRAVE. Yes. But I would like to see the instruction of the Congress to the Executive to be that he should use this authority to vary tax rates so as to meet his obligations under the Employment Act.

Representative PATMAN. That sounds good to me. I like it very much.

Mr. MUSGRAVE. I would not authorize him or instruct him, specifically to retire the debt. I would say that he ought to retire the debt if this is necessary and in line with meeting his obligations under the Employment Act.

Representative PATMAN. But you would include balancing the budget of course, because that is one of the basic things that you need in order to carry out the Employment Act?

Mr. MUSGRAVE. Under certain circumstances; yes. Under other circumstances a deficit may be needed.

Representative PATMAN. When times are good, not when times are bad?

Mr. MUSGRAVE. When times are good, a surplus may be in order.

Representative PATMAN. Now then did you not get out a new book recently, Dr. Musgrave?

Mr. MUSGRAVE. I am afraid I did.

Representative PATMAN. What is the title of it?

Mr. MUSGRAVE. The title is "The Theory of Public Finance."

Representative PATMAN. It deals with fiscal policies, does it not?

Mr. MUSGRAVE. It deals with fiscal policies, the general problem of Government finance.

51708—60——17

Representative PATMAN. Now I suggested yesterday to a witness that we might consider tying the bank rate, that is the going rate charged to customers by a bank, to the discount rate. Of course, you would have to tie the wholesale rate to the banks to the discount rate. And then tie the discount rate to the 91-day bill rate. Have you given consideration to anything like that? Now in England I think they tie the bank rate to the discount rate and in Canada they tie the discount rate to the short-term interest rate. So in combining the two do you think it would be possible to work out a formula in this country that would make it desirable and in the public interest to consider tying the discount rate to the 91-day interest rate which is developing into the only competitive industry we have in the country?

Mr. MUSGRAVE. I believe that a good case can be made for making the fluctuations in the discount rate more automatic in response to the market. I know that Professor Smith has given a good deal of thought just to this very point.

Representative PATMAN. Before I ask him about this, I want to ask you another question: Do you see any good reason why the Federal Reserve should not act to prevent such a broad difference in rates that are charged in different regions of the country? Take for example the conventional home loan rate, we will say. It is about 6 percent, about 5½ percent in New York, and in New England, and it is 7.2 in California and Western States. Now if I understand anything about the Federal Reserve Act I think one of their main reasons for the enactment of the Federal Reserve Act in 1913 was to make credit avaible uniformly all over the Nation by using the credit of the Nation for everybody, and have no discrimination, have no differences in the rate or no substantial differences. Would you like to comment on that?

Mr. MUSGRAVE. I have been rather on the other side of that fence. I have not been in sympathy with emphasis on the regional nature of the Federal Reserve banks and on regional aspects of Federal Reserve policies. Rather I think that the Board should concern itself with general national monetary policies, and that then the flow funds between regions should be left to the functioning of the capital markets.

Now it may well be that there should be an improved fluidity of funds from one part of the country to another, but I would not like to mix this up with the stabilization function of monetary policy, which is really a national problem.

Representative PATMAN. Yes, sir. Well, you heard my questions to Dr. Smith a while ago about the $15 billion. Do you know about that proposal, Dr. Musgrave?

Mr. MUSGRAVE. Yes, I heard about it yesterday.

Representative PATMAN. Would you like to comment on it? I know that you would like to reduce the national debt if you could. May I start it off this way: Do you share Dr. Smith's views in his statement that he does not see any good reason why the Federal securities held should be carried as a part of the national debt? Do you share his views on that?

Mr. MUSGRAVE. Yes.

Representative PATMAN. In other words, why do you share his views on that, Dr. Musgrave?

Mr. MUSGRAVE. Maybe just because we have given a seminar in monetary policy for so many years together. But more substantively, the point is that the Federal Reserve is essentially part of the Government, and that there is a problem of debt management only to the extent that it affects the liquidity of the public. Contrary to what Mr. Martin suggested yesterday, the concept of liquidity cannot be applied to the Government itself. Therefore, the debt held by the Fed is outside the problem of either monetary policy or debt management. I really do not care where this debt is, the Treasury gets the revenue anyhow.

Representative CURTIS. Would you yield?

Representative PATMAN. I yield.

Representative CURTIS. I think Mr. Martin is referring to liquidity in the Federal Reserve system. I think there is a big difference. You still think liquidity in the Federal Reserve system makes no difference?

Mr. MUSGRAVE. The way I used this terminology I thought of the Federal Reserve as being part of the Government. It is no private institution.

Representative CURTIS. I just wanted to get it clarified.

Representative PATMAN. In other words, you agree with Mr. Martin and with the members of the Board of Governors and the Secretary of the Treasury and everyone who has testified on it that the private commercial banks do not own a proprietary interest in the Federal Reserve System?

Mr. MUSGRAVE. Yes, I do.

Representative PATMAN. That is your view too, Dr. Smith?

Mr. SMITH. Yes.

Representative PATMAN. And that being true you believe this should not be carried as part of the national debt?

Would you look with favor upon some plan if the plan proposed is not in accordance with your desires or wishes, would you look with favor upon some plan that would cancel $15 billion of that debt that is now held by the Open Market Committee since the debt, Federal securities, have actually been paid for once by the Federal Reserve using Uncle Sam's money, the Federal Government money to retire those securities, not to retire but to pay them?

Mr. MUSGRAVE. I would feel that the taxpayers or the debt managers stand neither to gain nor to lose from this proposal. I would really feel indifferent to it. As Mr. Smith pointed out that something is to be said for the Fed holding unspecified debt at large which can be traded at the Treasury against whatever issues it would like to have for open market operations.

Representative PATMAN. The Federal Reserve Open Market Committee holds now in its portfolio $27 billion in Federal securities that they have acquired by giving another form of Federal security in return for it so in effect it is just like having a mortgage on your home and letting your agent have your money to go pay the mortgagee and he takes your money and he pays the mortgagee but, instead of canceling the mortgage, he has it transferred to himself and then he wants you to pay interest to him.

When the interest becomes due and mortgage matures, he wants you to pay him for it. That is similar, the way I see it, to what we are doing now with the Federal Open Market Committee. They are

using Uncle Sam's Bureau of Printing and Engraving, another form of obligation which is Uncle Sam's obligation——

Mr. MUSGRAVE. But they are Uncle Sam.

Representative PATMAN. That is right, they are Uncle Sam and they are trading Uncle Sam's money for Uncle Sam's securities. Now those securities ought to be canceled. I would be willing to do what you say, leave the Federal Reserve sufficient securities for the purpose of doing the things necessary in carrying out and performing their functions as contemplated under law, but leaving them $12 billion would surely be enough. You know they only spend about $130 million or $140 million a year. That is their total expenses and much of that is to help the private commercial banks—money the private banks would ordinarily have to and actually did spend before we had a Federal Reserve System. Here is a case where the taxpayers are actually paying the expenses of the private commercial banks.

Mr. MUSGRAVE. They are getting it back through the Federal Reserve contribution to the Treasury.

Representative PATMAN. Not as a taxpayer but as a customer of a bank he gets it back. He gets the benefit of a customer of a bank, not of a taxpayer.

Mr. MUSGRAVE. Taxes will be lower because the Treasury gets revenue from the Federal Reserve.

Representative PATMAN. I did not understand that, Doctor.

Mr. MUSGRAVE. Let me put it this way. The interest payments which the Treasury makes to the Federal Reserve will not necessitate an additional burden on the taxpayer, to the extent of the 90 percent of these payments which the Treasury gets back.

Representative PATMAN. I think we are talking about different things and I will not pursue that further because time is getting away from us. But the difference in the $15 billion being disposed of, canceled, or immobilized, set aside, by the process mentioned and not doing it means a lot to the taxpayers. Now it is true that the taxpayer money paid in taxes is used to pay the interest on the $15 billion. The money flows right back over into the Treasury, 90 percent of it immediately, at the end of the fiscal year, and the other 10 percent is available and can be paid over just like the $266 million was paid over at the end of 1959, but if you cancel that they would not have to pay.

Mr. MUSGRAVE. But they would not get the income. Let us assume for a moment that the Federal Reserve will immediately return whatever interest payment it gets from the Treasury. This is not quite the case but let us assume this were so. Then if we cancel the debt which the Fed holds, would not the Treasury lose precisely as much as it gains, and therefore the situation be a matter of indifference to the taxpayer?

Representative PATMAN. I am looking at it from the standpoint of the taxpayer only. The taxpayer would not have to pay if these $15 billion bonds were canceled. According to your opinion it does not hurt him any to go ahead and have the bonds remain outstanding and let the taxpayer pay the money and it goes back in the Treasury for his benefit.

Mr. MUSGRAVE. Right.

Representative PATMAN. I see your point that possibly, overall, it does not hurt the taxpayer, but it would relieve him of the duty of paying interest on $15 billion that he otherwise has to pay interest on?

Mr. MUSGRAVE. I think the rates charged on the taxpayer would remain unchanged as a result of this. Because as the Treasury's interest expenditures go down so would its revenue go down.

Representative PATMAN. Yes, sir. But may I ask you and Dr. Smith to give further consideration to that bill that I have introduced to, in effect, cancel $15 billion of these bonds, and I state how it should be done. I think it is a safe, sound way. There are other ways but I think this is a safe, sound way.

I think it would reduce our national debt by $15 billion at least and then it would save the taxpayers as I have suggested the necessity of immediately paying interest on that amount of money. If you will give consideration to it, if you have any views if you will express to me, whether favorable or adverse, I shall appreciate it.

Personally, I want to thank you for the information you gentlemen have given to the committee; and, for the committee, I want to thank you. You have certainly been helpful to us. We appreciate it and committee witnesses have the opportunity to make any changes that are necessary in the text of their remarks in the transcript. Sometimes mistakes are made as you know and sometimes to bring out the real thought it is necessary to add a word or two or a phrase now and then which would be perfectly all right.

Are you through, Mr. Curtis?

Representative CURTIS. Yes.

Representative PATMAN. Tomorrow at 10 o'clock we will meet here in this room for labor comments, AFL-CIO by Mr. Walter Reuther, and then at 11 o'clock we have the Chamber of Commerce of the United States, Mr. Emerson Smith on management comments, and at 11:30 we have the National Association of Manufacturers. Tomorrow afternoon we have Agriculture at 2 p.m., Mr. W. E. Hamilton of the Farm Bureau of Federation, Mr. Angus McDonald of the National Farmers Union; and the National Grange will be represented by Mr. Herschel Newsom. There is also to be a panel discussion. At 3:30 p.m., Mr. T. V. Houser will file a statement for the Committee of Economic Development. At 4 p.m., Federal Statistics Users' Conference, Mr. Arthur Chavous, of Sears, Roebuck & Co.

Without objection the committee will stand at recess until tomorrow morning at 10 o'clock.

(Whereupon, at 12:35 p.m., the hearing in the above-entitled matter was recessed, to reconvene at 10 a.m., Thursday, February 4, 1960.)

JANUARY 1960 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, FEBRUARY 4, 1960

U.S. CONGRESS,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in the Old Supreme Court Chamber, the Capitol, Hon. Paul H. Douglas (chairman of the committee) presiding.

Present: Senators Douglas, Sparkman, and Javits; Representatives Patman, Curtis, and Kilburn.

The CHAIRMAN. The committee will come to order.

Representative CURTIS. Mr. Chairman, before we proceed, I have a request to correct the record.

On February 2, 1960—I am sorry Congressman Patman is not here—Congressman Patman read a slight excerpt from an article in Business Week magazine of January 30, 1960. I had not seen the article or even known about it.

I said at the time that—

I thought I heard that correctly. That was amplification, was it not, that these decisions were made on a political rather than an economic basis?

Representative Patman replied, "From the Republican political campaign basis."

The article actually just says the opposite. Far from being an amplification of that, the headline of the article reads—

The Federal Reserve Chairman likes to stay aloof from politics, but he faces election year tiff over tight money.

Immediately after the excerpt that Congressman Patman read, it goes on to say—

In the traditional central bank style, Martin refuses to tip his hand,

and then it goes on to point out how he has not permitted politics to influence him.

I want to read from the closing part referring to Mr. Martin:

He has sometimes annoyed the administration, but never to the point of having to resign, and he has frequently annoyed Congress, but never to the point of a showdown.

I think because of the fact that reading just this one excerpt was unfair to the author of this article—and I want to say here publicly that having read the entire article I think it was an excellent job——

(At this point Representative Patman entered the hearing room.)

Representative CURTIS. Mr. Patman, I have made the remarks that I have now read the article from which you read the excerpt and far from being in context, you took it completely out of context because the article was advancing just the opposite theory that you were seek-

ing to advance: that Mr. Martin was motivated by political considerations.

The headline of the article you read reads: "Federal Reserve Chairman Likes To Stay Aloof From Politics."

Representative PATMAN. Suppose we put the whole article in.

Representative CURTIS. That is what I was going to suggest.

Representative PATMAN. I did not want to be unfair to Mr. Martin.

Representative CURTIS. Not only unfair to him, but unfair to the author.

Representative PATMAN. I do not accept that statement. Whatever I quoted is what was said.

Representative CURTIS. You quoted out of context.

Representative PATMAN. He was here.

Representative CURTIS. He did not read the article. The article ought to be in the record and I hope in the future that kind of proceeding is not indulged in in this committee or any other committee.

Representative PATMAN. I read exactly what was in here and I do not think it is out of context either.

Representative CURTIS. We will put the whole article in.

Representative PATMAN. That is right.

Representative CURTIS. I might say this to the gentleman from Texas: that I asked this question—I read this—"I thought I heard that correctly," referring to what you read. "That was amplification, was it not"—and I turned to you—"that these decisions were made on a political rather than economic basis?"

Your reply was, "From the Republican political campaign basis." The article was just the opposite. The main tone and tenor of the article was that Mr. Martin had tried to keep the Federal Reserve from being thrown into politics and had been very successful.

Representative PATMAN. This I say is not out of context because it is separate and distinct from the other part of the article. I want to read again.

Representative CURTIS. No.

Representative PATMAN (reading):

> Sticking to his guns: Some Wall Street observers think that despite his convictions, Martin will avoid a head-on fight by subtly easing credit sometime later this year. They reason that he does not want to jeopardize the administration's chances in the election.

Representative CURTIS. All right.

Representative PATMAN (reading):

> In the 1952 campaign he delayed putting through a rise in the discount rate until after Eisenhower's victory. This, they claim, may happen again.

That is not out of context. That is separate and distinct from the other.

Representative CURTIS. Just a minute. I asked you this question, Mr. Patman:

> That was amplification, was it not, that these decisions were made on a political rather than an economic basis?

In other words, I was trying to find if that was in context or out of context, and your answer did not recognize that was completely the opposite tenor of the article.

Representative PATMAN. We will settle that by putting the whole article in.

Representative CURTIS. I think so.

The CHAIRMAN. By unanimous consent, the full text of the article will be inserted at the conclusion of Mr. Martin's testimony.

(The article referred to may be found on p. 213.)

Representative CURTIS. Thank you.

The CHAIRMAN. This morning we are going to hear comments from representatives both of labor and management on the Economic Report of the President, and we have divided the time evenly between these two groups. The first hour will be taken by the representative of the AFL–CIO. The second hour will be taken by representatives of the chamber of Commerce and the National Association of Manufacturers.

In the second hour, therefore, I will ask the comments and discussion to be limited to approximately an hour and I will ask the representative of labor not to take more than an hour. Since the discussion between the members of the committee and the commentators is at least to our mind valuable, I hope the men who are going to read papers will be reasonably concise and offer an opportunity for discussion.

We had hoped that Mr. Walter Reuther, representing the AFL–CIO, would be here this morning, but he is ill with the flu and so his place will be taken by the very able director of research, Mr. Stanley Ruttenberg. Will you proceed?

STATEMENT OF WALTER REUTHER, PRESIDENT, UAW–AFL–CIO, AS PRESENTED BY STANLEY RUTTENBERG, DIRECTOR OF RESEARCH

Mr. RUTTENBERG. Thank you very much, Senator Douglas.

May I have inserted into the record the statement of Walter Reuther presented on behalf of the AFL–CIO in his capacity as the chairman of the AFL–CIO Economic Policy Committee?

The CHAIRMAN. That will be done.

Representative CURTIS. I just wanted to comment that it is a 45-page statement. I regret we will not have an opportunity of interrogating Mr. Reuther on it, and probably not you either, but I am very happy to have the statement.

The CHAIRMAN. I hope Mr. Ruttenberg will be able to condense the statement so that there will be opportunity for discussion.

Representative CURTIS. We will have it on his statement, but I understand Mr. Ruttenberg is going to make his own statement. I just want to make the record show that we will not have an opportunity of going over the statements of Mr. Reuther. I am sure there would be a lot of questions I would have liked to have asked him on it and possibly if I can thumb through it fast enough I may be able to ask Mr. Ruttenberg some of the questions.

Mr. RUTTENBERG. I would like to say, Congressman Curtis, that I would like the statement inserted in the record and I will attempt to summarize it, but in summarizing it I will not try to attribute it to what Mr. Reuther would have said if he summarized it. It will have to be a summary in my own name, but it will be a summary of the document and whatever is in the document I am prepared here to answer and comment upon if you care to raise questions.

Representative CURTIS. Thank you.
(Mr. Reuther's statement 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 held at a time when our country is failing to measure up to its economic opportunities at home and failing to respond to the economic challenge that faces us in the world. At home we see the paradox of a great backlog of unmet needs, both public and private, side by side with the highest plateau of unemployment during any so-called recovery year of the postwar period. Abroad, at a time when emphasis in the world contest between freedom and tyranny is shifting increasingly to the economic sphere, the economic might of the Soviet Union is growing by leaps and bounds, while our own economic growth is lagging far behind.

At such a time, our Federal Government can have few tasks more important than to effectuate economic policies which will enable us to meet our needs, create job opportunities for our unemployed, and achieve the high rate of economic growth of which we are potentially capable. But today we are far indeed from achieving that goal.

The American economy today is enjoying a limited measure of improvement which is far less than a return to economic health, and which threatens to prove no more than a lull between two recessions. Already a recession in 1961 is being generally predicted by economists. If we permit a recession to develop, it might well the the sharpest and deepest we have experienced since the 1930's. So far our postwar experience has been that each recession has cut more deeply than the one before it. There is nothing in the present economic policies of the administration to give us much hope that the trend will be reversed.

The fact that clear-sighted economists can already see the next recession gathering form on the horizon does not mean that it is in any way inevitable. Economic conditions are not the result of immutable natural laws. Economic conditions are created by men, and can be shaped by men. It is not too late yet to prevent another recession. But to do so requires the adoption of dynamic, forward-looking programs which will begin to catch up with the backlog of our unmet private and public needs, increase the demand for goods and services, stimulate the growth of our whole economy at a rate commensurate with our capabilities, and start us moving in the direction of an era of full production, full employment, and vibrant economic health. The implicit assumption behind all the prophecies of a recession in 1961 is that such policies will not be adopted, that the policies which have been persisted in by the present administration will continue to remain in effect. If that is permitted to happen, then another critical recession in the relatively near future is indeed inevitable and we should set about strengthening our counterrecessionary measures without delay.

No time for complacency

The danger of a recession will be vastly increased if the American people allow themselves to be lulled into the kind of complacency about our present economic situation that permeates the Economic Report of the President. The facts of our situation do not justify any feelings of complacency.

In order to create the illusion of a growing, healthy economy the Economic Report measured our economic growth in various respects since 1946. But consideration only of the total gains made since 1946 obscures the fact that most of those gains were made in the early part of the 13-year period. It is as if a doctor were asked to examine a child whose state of health for some time has ranged between poor and indifferent, who has failed to gain weight as he should and has suffered from recurrent wasting fevers. If the doctor were to assure us that the patient is really in glowing health because he is so much bigger and heavier than he was 13 years ago, we would consider such complacency to be criminally blind.

The fact is that in recent years our economy has failed to make any substantial progress. Economic growth has barely managed to keep ahead of the rate of population increase. Data in the Economic Report of the President measure our gross national product each year per unit of population in dollars of constant purchasing power. By this realistic measure, real GNP per capita

has increased by a total of less than 1 percent since 1956, and for the total period since 1953 it has averaged less than six-tenths of 1 percent per year. The great increases in productivity which have been made possible through technological progress have not been reflected as they could in expanding production, but to a substantial extent have resulted only in spreading unemployment.

The high rates of unemployment we experienced during the recent recession, higher than we have experienced for any substantial period of time since the 1930's, shocked many people into a realization that our economy is still far from recessionproof. But in terms of our economic health for the long run, there is cause for even greater concern in the fact that ever higher levels of unemployment are persisting even in periods of so-called recovery. In 1959, which the Economic Report hails as a year of recovery, unemployment averaged 5.5 percent of the labor force, only a small proportion of which can be attributed to the steel strike.

In absolute terms, unemployment in the "recovery" year of 1959 averaged 3.8 million—almost a million higher than the average of 1955–57, close to 2 million higher than the average for 1951–53, and even somewhat higher than the recession years of 1949 and 1954. In percentage terms, unemployment in 1959 was 5.5 percent of the labor force, compared with 5.9 percent in the recession year 1949, and 5.6 percent in the recession year 1954. It is a strange recovery which finds unemployment almost as high as in previous periods of recession.

Even the degree of recovery we are now experiencing cannot be considered to represent a period of normal economic growth, which might be expected to continue. As the Economic Report itself admits, much of the expectation for increasing demand and production during 1960 arises from the fact that business inventories generally have not yet been fully rebuilt from the low levels to which they declined during the recession, and they are particularly low in industries requiring steel. However, rebuilding of inventories is a process which quite obviously can provide only a short-term stimulus to the economy. It provides no basis whatever for expectation of continued growth beyond the next few months. Taking this as well as other factors into account, business analysts see the rate of growth beginning to slow as early as the second half of this year, with the prospect of moving toward a recession in 1961.

In short, the factors necessary for continued full production, full employment, and steady growth in our economy simply are not present.

Instead, for the second time within the brief lifetime of the present administration, we are moving out of a recession into a "recovery" that is no true recovery at all, with the signs clearly portending that unless there are vigorous and immediate changes made in our national economic policies, we shall soon be staggering into a third recession.

Policies based on fear of growth

Why have the policies of the current administration failed so miserably to maintain the economic health of our Nation?

Primarily, the administration's policies have been doomed to failure because they have been policies based on fear of growth—or, more precisely, they have been based on fear of or hostility to those forces in our economy which make for growth, which are essential to growth.

The primary essential for growth in our economy is a steadily increasing demand for goods and services. But this administration has interpreted every expansion of demand as a threat of inflation, something to be checked and impeded by Federal policies rather than stimulated and encouraged. Deprecating this fear of growth, Dag Hammarskjold, Secretary General of the United Nations, recently said:

"Although the slack in the industrial economies resulting from the recent recession has not yet been taken up, governments are beginning to show concern about the current expansion, and in some cases have already taken steps to slow down the rate of growth * * *. I wonder whether we are displaying as much concern about the slowdown in economic growth as we are about the dangers of price inflation."

The essence of the administration's tight-money policy, which it has pursued with unrelenting fervor, is the apparent conviction that increased demands for goods and services must be nipped in the bud, or they will produce inflationary pressures. This is a false interpretation on two counts. First, it is not increases in demand which have produced the inflation from which we have suffered in recent years. That is clearly shown by the fact that many prices went up even

in the recession, when demand was sharply curtailed. Evidence given before the Senate Antitrust and Monopoly Subcommittee, and the findings of that committee on the evidence, point in an entirely different direction, to the abuse of price-administering power by key corporations.

The fear that increased demand will produce inflationary pressures is falsely grounded also because that is a phenomenon typically found only when demand is pressing on the limits of productive capacity—and our situation is far from that. With over 3½ million workers still unemployed, with a substantial proportion of our productive equipment still idle, increased demand would simply provide the stimulus to put idle men and idle machines back to work. Higher levels of production, in turn, would mean increased efficiency of production because the heavy fixed costs which are characteristic of mass product industries would be spread over a larger number of units. Thus, in our present situation, increased demand by stimulating increases in production to more efficient levels would in fact create opportunities for price cuts in some industries rather than pressures for price increases.

A balanced budget or a balanced economy?

Another policy which the administration has pursued consistently, blindly and for the most part vainly, is the attempt to achieve a balanced budget through restrictions on Federal spending. This policy has been based in part on the same fear of any increase in demand, and in part on a 19th century concept of proper fiscal policy and the role of government in our economy. The present administration is obsessed with the twin ideas that Government activity to meet our public needs in such fields as health, education, welfare, and others is somehow inferior to private activity, and that the health of the economy is better assured by policies designed to balance the Federal budget at low levels of activity than by policies designed to stimulate economic growth and in doing so to increase Government revenues.

The result of a budget policy based on these two obsessions is that we have failed disgracefully to provide the services our people need, and we have incurred the biggest peacetime budget deficit in our Nation's history.

The failure to recognize and accept those obligations which only the Federal Government can effectively carry out has led to serious deficiencies in our national well-being. It has meant the starvation of our school system, which not even the deep concern resulting from our obvious educational lag behind the Soviet Union has served to remedy. It has meant failure to keep up with the overwhelming majority of western nations in the provision of adequate health services available to all who might need them. It has meant denial to our senior citizens of adequate standards of decency, comfort and dignity which they have earned in a lifetime of work. It has meant perpetuation of substandard incomes for millions of farm and city families. It has meant the continued existence of both urban and rural slums which are a national disgrace as well as a financial drain on the communities which they disfigure. It has meant failure to give adequate protection to or make the most efficient use of our natural resources of land, water, and forest. There is a growing fear in the public mind that it has meant even failure to achieve those advances in the technology of defense which are essential to our national security.

All of these failures can be attributed in part to an obsession for a balanced budget—and we cannot even console ourselves with the achievement of having balanced it.

The administration has persisted in viewing the Federal budget in essentially the same light as an individual must consider his household budget. But there is no real analogy at all. Most of us as individuals have strictly limited family budgets, restricted by our incomes, the size of which is largely beyond our control. The amount of Federal revenues, on the other hand, can vary greatly, without any change in tax rates, depending on whether the economy as a whole is prospering or declining. And a policy of cutting governmental expenditures to a minimum, regardless of the needs that may be left unmet, may only result in lowering the general level of demand, and reducing economic activity so that Federal revenues are even more sharply cut.

The analogy between the Federal budget and the household budget is erroneous also because the budget itself represents only a portion of our national economic activity. If the Government is to be compared with the head of a household, responsible for the well-being of his family, then the proper responsibility of Government is not merely to keep the budget balanced, but to follow economic

policies which will help to keep the economy balanced. An economy of full production and full employment is one which will not only produce the highest standards of individual welfare, but will also produce the highest Federal revenues.

Unbalanced tax policies have also contributed to lack of balance in the economy. Such devices as accelerated depreciation and tax discrimination in favor of dividend income have been intended to stimulate investment, but in practice they have meant only that a heavier burden of taxation must be borne by middle- and low-income families, whose spending for other purposes is thus reduced. Investment is stimulated, not by giving more money to corporations and wealthy families, but by expanding markets through a better distribution of consumer purchasing power. When nearly one-fifth of our existing productive capacity lies idle, we must obviously get expansion of consumer demand before we can expect substantial expansion of capacity. Higher tax exemptions for most American families, releasing more of their income for their own spending, while at the same time closing tax loopholes that cost the government billions of dollars per year, would do far more to stimulate investment than any artificial incentives through tax concessions to corporations or wealthy individuals.

Still another factor contributing to economic stagnation has been the administration's consistent efforts to restrict the economic gains of the wage and salary workers whose individual income makes up about 70 percent of the total national income. This is the sector of the economy above all others where increased income is most quickly reflected in increased spending, and where the total level of spending is of most importance in maintaining markets for goods and services and thus in maintaining full production and full employmet. Yet the administration has consistently striven to mobilize public opinion in opposition to wage increases, and has urged workers to "hold the line" even when the economy most urgently required the additional purchasing power that wage increases supply. Not only has the administration aided and abetted its big business friends through direct efforts to restrict wage increases, but it has worked to push through Congress restrictive labor legislation whose only effect can be to make still more difficult the efforts of millions of unorganized workers to improve their lot through union organization.

We need a positive program

Today, as never before, America needs a positive program for economic growth. Our potential capacity for growth is greater than ever before in our history. The vest steps forward in science and technology which have been achieved since World War II could help us to build for the first time in human history an economy of true abundance—an economy whose potential abundance can provide higher living standards, greater opportunity for education, increased meaningful leisure and human development and fulfillment at home and at the same time enable us to make an increasing contribution in the world struggle against poverty, hunger, ignorance, and disease in the positive fight against communism.

We have at hand the physical means and the technical skill to make this age-old dream of abundance come true. What we have lacked is leadership with the vision to recognize the possibilities before us, with the intelligence to free itself from the concepts which belong to a past age of scarcity, and with the courage and vigor to map out new programs appropriate to the needs and the promise of the new world of today.

THE OUTLOOK FOR 1960

As we enter the 1960's, America must choose dynamic economic policies to meet the Nation's needs in the second half of the 20th century or face a continuation of the past 7 years of stagnation and recurring recessions, one of which may develop into a disastrous downward spiral.

Recession-breeding policies are undermining the economy's forward advance at present, and threaten to produce a general economic decline in 1961. In the name of fighting a nonexistent runaway inflation, the economy is being squeezed despite continuing high levels of unemployment and persistent idle productive capacity. The Government and parts of the business community are attempting to choke a continuing rise in the sale of goods and the creation of new job opportunities at a time when about 5 percent of the labor force remains jobless and approximately 16 percent of industry's productive capacity is idle.

These are the same policies that have produced two recessions in the past 7 years and have dangerously cut down America's average rate of economic growth from 4.7 percent a year in 1947–53 to 2.3 percent a year in 1953–59, while the volume of total production in the Soviet Union has risen some 6 percent to 7 percent a year. After accounting for a growing population, per capita total production in the United States has been squeezed from an average rate of 3 percent a year in 1947–53 to only six-tenths of 1 percent a year in 1953–59—merely one-seventh the rate of the Soviet Union.

The onslaught against economic growth, in the name of combating the phantom of runaway inflation, centers around the following misguided policies:

1. Tight money and high interest rates: Ever since early 1953, the Government has continuously followed a policy of tight money and high interest rates, except during the depths of the recessions of 1953–54 and 1957–58. This monetary policy slows down the rise of sales and production and increases unemployment. At present, the money supply is a smaller percentage of total national production than at any time since the late 1920's, before the great depression. Interest rates are higher than they have been in over a quarter of a century, and there is a danger that they may go higher. Economic progress requires a growing money supply and lower rates of interest to foster rapid economic growth and the creation of new job opportunities for full employment.

2. Restrictive Federal budgets: For 7 years, the administration has consistently followed a self-defeating policy of attempting to balance the Federal budget at relatively low levels of sales, production, employment, and incomes, by sweeping under the rug the Nation's needs for comprehensive national defense and public-service programs. This mistaken policy has resulted in a lag in critical areas of national defense, as well as in a continuing deterioration of public services. It has also resulted in a rise of the national debt of over $18 billion and budget deficits in 4 of the Administration's 6 past budget years—deficits that flowed from the inadequate tax revenues of two recessions and slow economic growth. The administration's budget proposals for fiscal year 1961 are a continuing blend of pennypinching for national defense and public services, coupled with increases for postal rates and gasoline taxes. While budget surpluses are a worthwhile goal, they should not be achieved by curbing the growth of sales, production, incomes and jobs, and by dangerously ignoring national needs. A responsible budget policy would aim for surpluses that arise from the increasing tax revenues of a growing and balanced full employment economy, and not from an economy in which labor and industrial capacity are idle.

3. Unbalanced tax policy: The revisions of the Federal tax structure that were adopted in 1954 gave special tax concessions to corporations (accelerated depreciation) and wealthy families (reduced taxes on income from dividend payments). Between 1953 and 1959 the flow of cash to corporations (after-tax profits and depreciation allowances) rose by nearly three-fifths while after-tax personal income increased less than one-third. This kind of unbalanced flow of funds and the accompanying lack of balance between increasing productive capacity and lagging sales in 1956–57 was the underlying cause of the last recession. The continuing lack of balance between the increase in spendable cash to corporations and consumers threatens to continue a recession-breeding lack of balance between the economy's improving ability to produce and its ability to consume.

4. Attacks on trade unions and collective bargaining: Within the past several years, a stepped-up attack on trade unions and collective bargaining by parts of the business community has been added to the list of restrictive policies. This attack aims at reducing the rise of real wages and salaries, which are the basis of America's mass markets. If it should succeed, it would result in a slower increase of consumer buying power and a slower growth of consumer markets, while both the labor force and productive capacity are growing.

Current economic trends

The new decade of the 1960's begins with a "boom" that includes both a high rate of joblessness and considerable idle industrial capacity.

Sales, production, and incomes are rising now, as business rebuilds inventories of steel, steel products and autos, which were reduced during the steel strike. Despite this rise of economic activities, the number of nonfarm wage and salary jobs is hardly any greater than it was in July 1957, before the last recession started, and the number of jobless is about 5 percent of the labor force.

Industrial production, employment, and unemployment

	Industrial production	Nonfarm wage and salary jobs	Unemployed as percent of labor force
		Millions	*Percent*
July 1957 [1]	154	52.5	4.2
April 1959 [2]	132	50.1	7.5
1959:			
1st quarter	154	51.9	6.0
2d quarter	165	52.1	5.0
3d quarter	159	52.3	5.4
4th quarter	159	52.2	5.6
December 1959	165	52.5	5.2

[1] Before start of 1957-58 recession.
[2] Recession low point.

NOTE.—All figures are adjusted for seasonal changes.

Source: Federal Reserve Board and Department of Labor.

By midyear, however, the rebuilding of business inventories can be expected to ease. Yet Government policies are designed to nip the present rise long before full employment and maximum use of productive capacity are reached.

With the Federal Reserve System's rediscount rate at 4 percent and the prime interest rate for the best credit risks at 5 percent, interest rates for home buyers, small-business men, farmers and consumers generally are now 5½ percent, 6 percent, 7 percent, or even more.

The tight-money policy has already brought a slump in homebuilding—new housing starts have declined from a yearly rate of 1.4 million early last year to 1.2 million in the October-December quarter and are expected to decline further in 1960. Construction programs of many State and local governments are being curtailed or postponed, because borrowing has become too expensive. Farm investments in construction and new equipment will probably slip in 1960, as a result of the combined effect of tight money and declining farm income. If the tight-money squeeze continues, it will gradually curb the purchases of small businesses, farmers, and consumers. An increasing number of economic activities may be squeezed, therefore, at about the same time as the current inventory buildup eases.

Present indications point towards a considerable slowdown of the economy's forward advance after midyear. This slackening of the pace of economic progress, following the early months of inventory buildup, can be seen in steel and auto industry reports.

Steel industry leaders expect the industry to produce about 70 million tons in the first half of the year, with operations at approximately 93 percent of capacity. During the second half of the year, industry leaders expect steel production to be cut to about 60 million tons, with operations at approximately 80 percent of capacity.

The auto industry has scheduled the production of over 2¼ million passenger cars in the January-March quarter. Industry leaders, however, expect auto sales to be about 7 million in 1960, including approximately 500,000 imports. The production schedules of January-March, therefore, are not expected to be maintained. They will be cut back in the spring and summer, depending on the trend of actual sales, after dealers are restocked.

While consumer purchases are expected to increase during the course of 1960, this rise may slacken in the latter part of the year. Wage and salary incomes are now rising, with the increase in production, as heavy goods inventories are rebuilt. But a slowdown of the economic advance after midyear will result in reduced earnings for many workers and a slackening of the growth of consumer buying power.

Furthermore, the increase of consumer credit, which supported a considerable portion of the rise of consumer spending in the past year, may begin to taper off in the months ahead. Outstanding installment credit rose by a record $5.6 billion between December 1958 and December 1959. It cannot be expected to rise at anything like this pace indefinitely.

Increase in outstanding installment credit

	Billions
December 1954 to December 1955	+$5.4
December 1955 to December 1956	+ 2.9
December 1956 to December 1957	+ 2.3
December 1957 to December 1958	+ 0.1
December 1958 to December 1959	+ 5.6

Source: Federal Reserve Board and Council of Economic Advisers.

A tapering off of installment credit may occur about midyear—at about the same time that the inventory buildup eases. Such a development would mean a slackening of consumer buying of hard goods, when other economic activities are slowing down, unless there is a substantial and continuing rise of consumer buying power.

Are there other economic forces that can be expected to boost sales, production, incomes, and jobs in the latter part of 1960, after the inventory buildup eases and when consumer hard goods purchases may weaken?

Federal expenditures, according to administration plans, will rise slightly in fiscal year 1961, indicating the possibility of a small rise of Federal outlays in the second half of the year. State and local government expenditures are scheduled to continue rising through 1960, although tight money and high-interest rates may curb the increase. Total government outlays—Federal, State, and local—will probably rise in the latter part of the year, adding somewhat, but not greatly, to the demand for goods and services.

Exports, too, are expected to improve this year and a more favorable balance between exports and imports should provide another small addition to economic activities in the second half of the year.

Business investments in new plant and equipment—particularly the investments of large corporations—are expected to rise by 10 to 15 percent in 1960. The large corporations, with their huge financial resources, are immune to early effects of a tight money squeeze. These investments, with emphasis on cost-reducing automatic and semiautomatic equipment, will probably continue to rise in the latter half of the year, adding about 3 to 4 percent to industrial capacity during the course of 1960.

On the basis of present trends, therefore, most lines of economic activities will be slowing down or declining toward the end of the year, except for the investments of large corporations in new plant and equipment. The restrictive squeeze on economic growth will be making itself felt, as it did in late 1956 and early 1957, before the last recession. Industry's capacity to produce more goods, much more efficiently, will continue to rise slowly, as new equipment is added and old equipment is replaced, while sales and new orders for goods may be lagging or beginning to fall.

Thus, we appear to be headed for a decided slowdown in the rise of sales, production, incomes, and jobs after the early months of 1960, unless restrictive and unbalancing policies are swiftly changed.

Predictions of a recession

It is for these reasons that many conservative academic and business economists predict a recession in 1961. William F. Butler, vice president of the Chase Manhattan Bank, for example, recently told the American Petroleum Institute that "the rate of advance will be slower during the second half [of 1960]. The pressure to build inventories will ease. The major expansion will be in plant and equipment expenditures. * * * In 1961, general business may move into a virtual plateau, preceding another general downturn."

Mr. Butler told the top executives of the Nation's oil companies that it is "too early to talk in any specific fashion about the precise timing of the next business downturn." But he warned the oil industry executives to "watch with increasing vigilance for signs of the next recession as we move through 1960 and into 1961."

It is not that general economic declines are inevitable, as some people seem to believe. Recessions are man made, the result of errors of judgment and misguided policies.

If a recession occurs in 1961, it will not be due to the workings of some natural law, as the changing seasons of the year. The much-predicted recession of 1961 will be clearly the product of the restrictive squeeze and unbalancing policies of the administration and parts of the business community.

Just as administration and big business policies brought on the sharp decline of 1957–58, so they are now providing the basis for a recession in 1961. A quick and drastic change of major economic policies is required to avoid another economic setback next year.

Policies to sustain growth through 1960

The recession-breeding and unbalancing policies of the past 7 years must be reversed. If the economy is to continue to expand through 1960 and avoid a recession in 1961, dynamic programs to sustain economic growth and to meet national needs are required quickly.

The tight money policy must be halted and an adequate money supply must be provided to achieve maximum production and employment. National needs must be met by expanded and comprehensive Federal programs of direct financial assistance, grants-in-aid to States and local governments and long-term, low-interest loans to improve such public services as education, health, community facilities, urban redevelopment, low- and middle-income housing, the conservation and development of natural resources. Defense expenditures must be raised, if necessary, to meet the Nation's defense needs. A revision of the tax structure is required to provide a more equitable means for raising Federal tax revenues.

Continuing improvements in wages and salaries are needed, particularly for low-wage workers, to provide growing, mass consumer markets.

Such measures are needed to achieve a balance between sales and the economy's improving ability to produce a rising volume of goods and services.

Counterrecessionary policies are essential

While a recession in 1961 is probable unless major changes are made in the present economic policies of the administration, the Nation is ill prepared with counterrecessionary tools. We must move without delay to adopt measures designed to minimize the impact and shorten the duration of future declines in economic activity.

The unemployment insurance system, which offset approximately one-fifth to one-fourth of the decline of total wage and salary payments during the last recession, should be improved. The adoption of Federal standards to increase benefit levels and the duration of unemployment insurance payments would aid unemployed workers and their families and improve the counterrecessionary effect of the unemployment insurance system. The Social Security Act should be improved to provide increased benefits and hospital and medical care protection to those who are eligible for old-age and survivors' insurance and provide more adequate retirement incomes for older workers who may be laid off during a general economic decline.

A comprehensive, national shelf of public works programs should be established now, to be put into operation promptly, as soon as a recession starts. Such quick action, at the very beginning of a general decline, would stimulate the demand for construction materials and heavy goods, when those industries would be weakening, and it would increase employment opportunities.

All plans for new public facilities, such as Government buildings and post offices, should be examined to determine which of them are most readily available for prompt action. Planning, blueprinting, and land purchases for such programs should be done before a recession starts. Federal technical aid should be made available to the States and local governments to establish State and local government shelves of public works programs, as well as one on the Federal level. Provision should be made for long-term, low-interest loans to facilitate execution of such projects at the State and local level.

These measures to strengthen the economy are needed, whether or not one believes that a general decline will occur next year. They should be adopted, without delay, in view of the present course of economic trends.

CONTINUING UNEMPLOYMENT AND IDLE CAPACITY

Unemployment has been rising in the past 7 years, under the impact of the administration's decisions to fight the phantom of runaway inflation with restrictive policies that curb economic growth and increase joblessness.

These same restrictive and unbalancing policies have created a continuing spread between industry's improving capacity to produce and lagging sales, during almost the entire period since 1953.

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Decisive changes of economic policies are required before the economy can achieve "maximum production, employment, and purchasing power" which is the Nation's economic goal under the terms of the Employment Act of 1946.

Rising unemployment, 1953–59

The economy has failed to provide job opportunities for a growing labor force in the past 7 years. While the labor force increased 5.6 million between 1953 and 1959, employment increased only 3.7 million, resulting in a 100-percent rise in the number of jobless.

[In millions]

	Labor force	Employment	Unemployment
1959	69.4	65.6	3.8
1953	63.8	61.9	1.9
Total	+5.6	+3.7	+1.9

Young people entering the job markets, without specialized training, technical or professional skills, have found jobs increasingly difficult to obtain. Workers who have been laid off from their regular jobs have found few alternative job opportunities at similar skill requirements or wages. The economic pressures of joblessness have been greatest for production and maintenance workers in manufacturing, mining, and railroads, where employment has fallen in the past 7 years.

The major cause of the economy's inability to provide enough new job opportunities has been the slowdown of economic growth. A contributing factor has been radical technological change and rapidly rising productivity, particularly in manufacturing, mining, and railroads, where employment has declined and industry has shut down facilities or shifted locations.

Unemployment has been creeping upward since 1953. The number of jobless rose during the recession of 1953–54 and never returned to the prerecession level. The economy, which never fully recovered from that recession, entered the 1957–58 decline with an unemployment level that was already high, and joblessness rose sharply as production was cut back. Now, 1 full year since production has returned to prerecession peaks, unemployment is greater than in 1955–57. It appears that the economy is not fully recovering from the 1957–58 recession, as it failed to recover fully from the 1953–54 recession.

	Number of jobless	Unemployed as percent of labor force
	Millions	*Percent*
1951–53	2.0	3.1
1954 [1]	3.6	5.6
1955–57	2.9	4.3
1958 [1]	4.7	6.8
1959	3.8	5.5

[1] Recession years.

Source: Department of Labor.

An indication of the persistent nature of rising unemployment can be seen in the Labor Department's figures on long-term joblessness. The number of people unemployed 15 weeks or more has increased both in numbers and as a percent of all unemployed persons.

Long-term unemployment is rising

	Total number of jobless	Unemployed 15 weeks or more	Long-term unemployed as percent of total number of unemployed
	Thousands	*Thousands*	*Percent*
1951	2,099	303	14.4
1952	1,931	232	12.0
1953	1,870	211	11.3
1954 [1]	3,578	812	22.7
1955	2,903	703	24.2
1956	2,822	533	18.9
1957	2,936	560	19.1
1958 [1]	4,681	1,452	31.0
1959	3,813	1,040	27.3

[1] Recession years.

Source: Department of Labor.

While unemployment has risen among young people entering the job markets, it has likewise risen among men 20 to 44 years of age, who are usually the heads of families, with young and growing children. In 1959, there were 1.2 million men in this age group who were unemployed—compared with 900,000 in 1957 and an estimated 700,000 in 1953.

The widespread character of the problem of rising unemployment can be seen in the Labor Department's report on areas of substantial unemployment. In November 1959, there were 32 major and 112 smaller industrial communities, where the number of unemployed was 6 percent or more of the labor force. This compares with 20 major and 57 smaller areas of substantial unemployment in November 1956 and with 18 major and 24 smaller distressed industrial communities in November 1953.

Unfortunately, the Government's figures do not tell the entire story, by any means. Figures cannot present the personal and family difficulties, related to loss of a job. Nor do the figures on unemployment present the picture of downgrading workers and underutilization of skills—the semiskilled and unskilled workers who lost their jobs in manufacturing, mining and the railroads, who are now part-time or full-time workers in low-paid jobs in retail and wholesale trade or the services. Nor do these figures tell us about workers in economically distressed communities, who left the job markets because work was unavailable and are, therefore, not ever included in labor force statistice.

Continuing high levels of unemployment and spreading underemployment are creating increasing difficulties for many American families. The waste of skills and loss of incomes, due to unemployment and underemployment, are sapping the economy's strength.

The employment-unemployment outlook for 1960

Current administration assumptions, implied in the President's budget message, are that the real volume of national production will rise approximately 5 percent between 1959 and 1960. A rise in output is produced by some combination of increased employment, increased output per man-hour of work, and possibly a change in working hours. How would a rise in real national output of 5 percent or so affect these factors?

Even if only three-fifths to four-fifths of the assumed 5-percent rise is produced by an increase in output per man-hour of work and the resumption of steel industry operations, which were shut down almost one-third of last year, unemployment would remain at disturbingly high levels. The remainder of the 5-percent rise in real national output—1 to 2 percent—would be based on a rise in jobs in private and Government employment and, possibly, some pickup in working hours.

Since there were 69.4 million employed in 1959, a 1-percent rise in jobs would mean an employment increase of about 700,000. A 2-percent rise in employment would mean 1.4 million additional jobs. An employment increase of 1 to 1.4 million in private and Government jobs may be a generous estimate, but it would not necessarily result in reduced unemployment.

The labor force is growing, as more young people leave school each year to find jobs. Its expansion slowed down during the 1957–58 recession. But by the end of last year, labor force growth was picking up again. On the basis of past trends and births, the Labor Department has projected an increase in the labor force in 1960 of over 1 million.

The expected growth of the labor force—by about 1 million or more—will offset, therefore, most, if not all, of the assumed 1 to 1.4 million rise in employment.

Last year, there were 3.8 million unemployed, or 5.5 percent of the labor force. It appears from the above assumptions, that the number of jobless in 1960 will probably be within a range of about 3.4 to 3.8 million, or approximately 4.9 to 5.4 percent of the larger labor force.

A 5-percent rise in real national output from a full-employment level would represent a substantial gain. From the slack level of 1959, however, a 5-percent increase in the volume of the Nation's total production is a very small improvement, indeed.

The administration's assumptions for 1960, therefore, mean a small rise in employment and the probability of continuing high levels of unemployment this year. Since the rise in economic activities will probably slow down considerably in the latter part of the year, the employment-unemployment situation may be worsening, rather than improving, toward the end of 1960, unless major economic policies are drastically changed.

Continuing idle capacity

There have been considerable amounts of idle industrial capacity during most of the period since 1953. Between the end of 1952 and the end of 1959, the productive capacity of manufacturing industries increased approximately 43 percent, while manufacturing production rose only 19 percent.

The McGraw-Hill "Survey of Manufacturing Operating Rates" indicates that except for the final months of 1955 and early 1956, manufacturing industries, as a whole, have operated considerably below maximum levels in recent years.

Operating rate as percent of capacity

End of year—	*Manufacturing industries, percent*
1954	84
1955	92
1956	86
1957	78
1958	80
1959 [1]	84

[1] AFL–CIO estimate.

Source: 12th Annual McGraw-Hill Survey, April 1959.

At the end of 1958, as the economy was rising out of the recession, manufacturing industries were operating at 80 percent of capacity. In 1959, there were increases in industrial capacity, as well as increases in manufacturing production. By the end of last year, industry was operating at an estimated 84 percent of productive capacity.

Most of the anticipated 10 to 15 percent rise in business investment for new plant and equipment in 1960 will be for modernization of machinery, which will reduce labor requirements in many industries, as the new equipment is installed and put into operation. New installations, however, will result in some increase in productive capacity—perhaps 3 to 4 percent.

Since manufacturing output is rising at present, it is likely that the utilization of industrial capacity will rise to about 87–88 percent, before the inventory buildup eases. But, in the second half of the year, manufacturing output will level off, on the basis of current trends. In the meantime, new installations will be increasing industrial capacity slowly.

The present course of economic developments, therefore, indicates that maximum capacity utilization this year may be about 88 percent, compared with 92 percent utilization in late 1955 and early 1956. With new equipment slowly adding to capacity in the second half of the year and manufacturing output expected to level off, the gap between lagging sales and increasing productive capacity probably will be widening in the latter months of 1960. A similar widening gap between sales and the economy's capacity to produce, during the latter half of 1956 and early 1957, set the stage for the 1957–58 recession.

The continuing waste of idle industrial capacity—and the recurrence of widening gaps between sales and the economy's ability to produce—reflects the effectiveness of the tight-money squeeze, restrictive Federal budgets and the lack of balance between consumer buying power and business investment.

America's ability to produce—its labor force and industrial capacity—have been partly wasted in the past 7 years. Present trends indicate that this waste will continue in 1960, and possibly worsen after the early months of the year.

Maximum utilization of available labor and productive capacity require an end to the tight-money squeeze, restrictive Federal budgets and unbalancing tax policies. America needs rising demand for goods and services through 1960 and not a tapering off of demand in the latter part of the year.

AMERICA NEEDS A FASTER RATE OF ECONOMIC GROWTH

The evidence conclusively proves that the slowdown of economic growth in the past 7 years has not been due to shortages of labor or productive capacity. The facts amply indicate that the economy's difficulties have been insufficient sales of goods and services—the result of the Government's economic squeeze and unbalancing policies.

The slowdown of economic growth has not been the outcome of shortages or accidents. Indeed, the slowdown has been abnormal. In the face of a continuing growth of the labor force and productive efficiency, it has taken a mighty Government effort to suppress America's potential for progress and to produce the snail's pace of growth of the past 7 years.

Economic stagnation has been expensive

The reduced pace of rising real national production from an average rate of 4.7 percent a year in 1947–53 to an average yearly rate of 2.3 percent in 1953–59 has been achieved at great cost. It has meant not only the waste of manpower and machines, but also the loss of billions of dollars of goods and services that could have been produced.

NATIONAL PRODUCTION DEFICIT

Gross national product (in 1959 dollars)

	Billions
1947	$315.7
1948	327.9
1949	328.2
1950	356.2
1951	385.0
1952	399.0
1953	417.1

[In billions]

	Actual growth rate (2.3 percent)	1947–53 growth rate (4.7 percent)
1954	$408.8	$436.7
1955	441.5	457.2
1956	450.9	478.7
1957	458.9	501.2
1958	448.6	524.8
1959	478.8	549.5

	Billions
1953–59 loss of production	$260
1953–59 loss of Federal revenue	50

Source: Actual GNP from Council of Economic Advisers; GNP on basis of 4.7 percent growth rate for 1953–59 computed.

Since the population has continued to grow—by 1.7 percent in 1947–53 and 1.8 percent in 1953–59—the slowdown of rising national production has meant that per capita national output has been cut down drastically from an average yearly pace of 3 percent in 1947–53 to a rate of six-tenths of 1 percent in 1953–59. With per capita national production almost standing still, improvements in living standards, public services, and national defense have been held back. Only a continuing and significant rise of per capita national production can provide

the needed margin of extra output, incomes, and tax revenues to support expanded defense and public service programs, while permitting improvements of living standards, particularly of low-income families.

The failure in the past 7 years to maintain the 1947–53 rate of rising national production has meant the loss of $260 billion (in 1959 prices) of production—a staggering loss of output that could have provided more adequate national defense as well as steps toward achieving public services to meet the needs of a growing population and toward eliminating remaining pockets of poverty. The cumulative loss of Federal tax revenue alone has been $50 billion, which could have been used in the past 7 years for the beginnings of comprehensive national programs to improve education, health, community facilities, and other public services.

The slow pace of economic advance has also contributed to a trend toward relative economic and military weakness, in relation to the Soviet Union. While the Soviet Union has continued to build up its military technology and to set up its economic attack, U.S. expenditures for national defense and foreign economic aid and development have barely held their own.

The Soviet Union's dictatorial assignment of resources and manpower plus rapid economic expansion have propelled that nation forward at a very fast pace, in terms of military and international power, during the past 7 years. In contrast, near-stagnation and restrictive budget policies in America's free society have produced relative military and economic weaknesses that can have increasingly dangerous consequences.

A 5-percent annual rate of growth is needed

The magazine Business Week (issue of Jan. 23, 1960) has pointedly stated the urgent need for a much more rapid rate of economic growth in the future. "The U.S. economy, in the years ahead, must grow at a strong rate or suffer some highly unpleasant consequences. Some of these are obvious, some less so:

"The U.S. population is increasing fast—and if economic growth does not at least keep pace with population growth, living standards will decline. * * *

"Without strong and sustained economic growth, the United States will have a serious and continuing unemployment problem on its hands, for the labor force is also growing rapidly. * * *

"Too slow growth would mean a sharper battle over the shares of the national income going to labor, management, farmers, shareholders, and property owners. * * *

"Finally, too slow U.S. growth would mean that the Soviet Union might succeed in its bid to achieve world domination through its own growing economic power."

A 5-percent average yearly increase of real national production is needed to keep up with America's population, which is growing at a yearly rate of 1.8 percent, and to provide the additional output, incomes, and tax revenues that are required for expanded public service and defense efforts, as well as improvements in living conditions. This view is now widely accepted, as in the Rockefeller Bros. Fund report on the American economy.

A 5-percent growth rate is both feasible and necessary to meet the needs of the American people. Indeed, failure to achieve a 5-percent growth rate will mean not only a continued lag in public services and national defense, but also continued high levels of unemployment.

Those who say that such achievement is impossible are either men of insufficient faith in America's potential or they are unacquainted with the economy's accelerating pace of advancing productivity and labor force growth.

Accelerating pace of advancing productivity

In recent years there has been increasingly widespread recognition of the fact that output per man-hour of work in our economy has tended to advance at an accelerating pace.

The record of the postwar period illustrates this fact. The recent Bureau of Labor Statistics study of productivity trends, for example, shows that output per man-hour in the total private economy increased at an annual rate of 3.5 percent during the period 1947–58, despite the years of economic stagnation and recession during that period. This 3.5-percent rate, which is obviously an understatement of our potential under conditions of full employment and steady growth, is markedly higher than the average rate of the preceding period of approximately four decades for which reasonably reliable data are available.

In the 39th Annual Report (1959) of the National Bureau of Economic Re-

search, Solomon Fabricant described the accelerating pace of advancing productivity. He wrote: "Also a fact of great importance, the long-term pace of advances in output per man-hour has speeded up. It was 22 percent per decade during the quarter century preceding World War I. It has averaged 29 percent since. During the most recent period—after World War II—national product per man-hour has been rising at an even greater rate, 35 to 40 percent per decade."

In my testimony before this committee last year, I presented some of the great mass of evidence supporting the conclusion that the rate of productivity advance has tended to accelerate in the past and will continue to accelerate in the years ahead. I quoted prominent economists and industrialists who explicitly recognize the fact of acceleration; I referred to the rapid increase in expenditures for research and development as one of the factors making for acceleration; and I cited certain major technological breakthroughs of wide applicability that promise the continuance of acceleration in the period ahead.

In addition, I presented to the committee a statistical analysis of the long-term productivity trend which showed that the rate of increase in output per man-hour worked has tended to accelerate significantly during the past half century.

The same type of statistical analysis is applied to somewhat different basic data in the new Bureau of Labor Statistics study of productivity trends. The Bureau's calculations based upon this method of analysis show that, for the period 1909 through 1958, the annual rate of productivity advance has tended to increase by 0.06 percent each year, rising from less than 1 percent at the beginning of the period to 3.9 percent per year as of 1958. (The corresponding figure for this year, 1960, is 4 percent.) These results closely approximate the findings I presented last year based upon the best data then available to our technicians.

Unfortunately, however, the Bureau of Labor Statistics failed to evaluate its findings with respect to long-term productivity trends. The "normal" rate of productivity advance has become a controversial matter both in collective bargaining and in politics. The Bureau sought to escape from involvement in this controversy by ducking the issue and omitting from its study, material which indicated the superiority over other methods of the kind of analysis of the long-term productivity trend which I presented to this committee last year. It included in the published version a great variety of widely divergent measures of the long-term productivity trend. The study presents no fewer than 40 separate figures, computed on different bases and ranging from 1.7 to 5 percent, all purporting to be the trend or "normal" annual rate of productivity advance as of 1958. The effect, obviously, is to confuse rather than to enlighten.

Thus, the Bureau has abdicated its responsibility to provide guidance on productivity trends to other Government agencies, the Congress, and the public.

Reliable analysis of productivity trends is essential, however, if we as a nation are to set realistic goals for economic growth as a basis for the development of policies designed to achieve those goals.

No one would contend, of course, that past productivity trends can properly be projected mechanically into the future. For reasons set forth in my testimony last year, I believe that we can do better in the years ahead than is suggested by the historical trend. Be that as it may, however, a sound and reliable analysis of the achievements of the past is certainly an important factor in making judgments about our possibilities for the future.

Neither the Bureau of Labor Statistics study nor any other known to me calls into question the essential validity of the conclusions I presented to this committee last year concerning past acceleration and the probability of continued acceleration of the rate of advance in productivity. Neither the propriety of the type of statistical analysis nor the significance of the nonstatistical material then presented has been effectively challenged or rebutted.

It seems entirely reasonable to conclude, therefore, that we should base our calculations and our plans for the years immediately ahead on continuing acceleration of the rate of productivity advance beyond the 4-percent annual rate that historical evidence suggests is the "normal" rate for this year.

Vigorous recovery from the lingering effects of the 1958 recession and elimination of the inefficiencies that result from present underutilization of installed capacity would raise productivity by more than 4 percent this year and next and would bring us closer to the long-term accelerating trend. Steeper than normal increases in productivity have been characteristic of past recovery periods. Rough calculations suggest that we came within reasonable range of the trend rate during 1959 despite the severe direct and indirect effects of the steel strike which centered mainly on industries of relatively high output per

man-hour. Unfortunately, however, present signs point toward a tapering off of the rate of recovery later this year and toward renewed recession in 1961, rather than toward rapid and sustained growth.

A faster rate of economic growth, in itself, will assure some stepup in the average yearly pace of productivity advance from 4 percent in the coming years, just as the slowdown of economic growth, particularly in 1956–58, produced a slower pace of rising output per man-hour in those years. A realistic appraisal of productivity trends, therefore, indicates that in the years ahead the productivity of the total private economy should rise by an average yearly rate of better than 4 percent a year, if productive efficiency is not suppressed by general economic stagnation.

An average yearly productivity rise of 4 percent or more provides one essential ingredient for a 5-percent average annual rate of economic growth. But output per man-hour of work is not the only factor. The other major factor that creates rising production is manpower.

Accelerating growth of the labor force

Growth of the American labor force is also speeding up. Each year, there are more people in the labor force—people who are willing and able to work. Between 1949 and 1959, the labor force grew by approximately 800,000 a year—or an average yearly pace of about 1.2 percent. The labor force is now beginning to feel the effects of the rise in the birth rate since 1940. An increasing number of young people are entering the job markets.

According to Labor Department projections, the labor force is expected to grow by about 1.2 million a year between 1960 and 1965—an average yearly rate of approximately 1½ percent. In the following 5 years, between 1965 and 1970, the Labor Department expects the labor force to expand by 1.4 million a year, or an average rate of about 1¾ percent a year.

An accelerating pace of advancing output per man-hour of work at an average yearly rate of 4 percent or more plus a stepped-up rate of labor force growth of 1½ percent to 1¾ percent a year makes an average yearly 5 percent rate of economic growth entirely feasible.

In fact, the combination of accelerating advances in productivity plus the projected growth of the labor force will enable us to achieve a 5-percent growth rate even as we progress in reducing annual hours of work per employed person through lengthened vacations, increased numbers of holidays and shortened workweeks.

Accelerating advances in both our productivity potential and the size of our labor force make a 5-percent economic growth rate not only feasible but urgently necessary.

With a step-up in both productivity and the labor force, continuation of a snail's pace of economic growth in the 1960's will mean a continuing rise of unemployment and mounting social and economic problems. Continued Government efforts to suppress economic growth in the years ahead can result only in increasing national troubles, both at home and in the international arena.

Positive measures needed for rapid growth

The slowdown of economic growth of the past 7 years has been the result of growth-stunting policies and not the result of shortages or accidents. A first and major step toward achieving the needed 5-percent average yearly rate of economic growth must be abandonment of these misguided policies—the tight-money squeeze, restrictive Federal budgets and unbalancing tax policies.

The money supply must increase adequately to provide the necessary funds for a continuing and rapid pace of economic growth. Lower interest rates are required to encourage expansion. The Federal budget policy must be changed—to begin to meet the urgent need for expanded public service and defense programs and to gear Federal budgets to achieve balance and surpluses from the rising tax revenues of a growing, full employment economy.

A substantial revision of the Federal tax structure is required—to close loopholes of special tax privileges for wealthy families and corporations and reduce the tax burden on low- and middle-income families—in order to raise needed Government tax revenues on a fair and equitable basis. Such a revision is needed to provide a better balance between consumer-buying power and business investment.

Consumer buying power must rise to provide the basis for expanding mass markets—through increasing wages and salaries and special government efforts to lift the family incomes of low-income groups.

Since recurring recessions have been an important factor in reducing the pace of economic growth, it is essential that (1) national economic policies attempt to provide a continuing balance between sales and increasing productive capacity, so that recessions may be avoided, and (2) the Federal Government must be prepared, in advance, to move swiftly, with counterrecessionary measures, in order to reduce the impact and duration of a recession, if one occurs.

In addition, the Federal Government should provide financial and technical assistance for the increasing number of distressed communities, to restore these areas, their people and businesses to full participation in the Nation's economic progress. A comprehensive national effort must be made in education, which provides the longrun basis for an advancing economy—not only in secondary and higher education, where the needs are well known, but also in vocational and technical education for the training and retraining of workers to adapt their skills to the requirements of a period of rapidly changing technology. Also, Government efforts, in cooperation with the unions and employers, are required to attempt to improve the productive efficiency of low-productivity industries.

A basic change in the tone of national leadership and policies is required to provide the American people with positive goals for social and economic progress. America's potential for continued growth must be given the direction and freedom that are necessary for meeting the Nation's needs.

WE CAN ACHIEVE PRICE STABILITY

The creeping rise of the price level in the past several years has been distorted beyond any relationship to reality in an attempt to provide justifications for economic policies that suppress growth and increase unemployment.

Only a recognition of the facts—which the Joint Economic Committee and the Senate Subcommittee on Antitrust and Monopoly have been presenting to the American people in the recent past—can establish the basis for practical remedies.

There have been three distinct and differing periods of rising prices since the end of World War II. In 1946–47, the price level rose sharply and consumer prices increased 30 percent. The major cause of this rise of the price level was the postwar release of pent-up demand for all kinds of goods and services and the early end of wartime price control authority. There were shortages of a wide variety of goods and industrial capacity. In 1948, the rise of the price level eased, as production increased and productive capacity expanded.

The outbreak of the Korean war in mid-1950 brought another period of sharply rising prices with excessive speculation, hoarding, and profiteering. Between mid-1950 and mid-1951, consumer prices increased almost 9 percent.

Close to three-fourths of the entire postwar rise of consumer prices occurred in those 3 years of war-related pressures—1946, 1947 and mid-1950 to mid-1951. Under conditions that existed in those 3 years, restrictive economic policies, such as tight money, can be used to squeeze the demand for goods when there are shortages. In the absence of excessive demand and general shortages, restrictive policies suppress economic growth and produce economic slack and unemployment.

During the 4 years from mid-1951 and mid-1955, the price level was reasonably stable. Many political and business leaders, however, began a stepped-up campaign, in those years, against a phantom inflation. In early 1953, the Government began to impose restrictive policies to curb the demand for goods and to suppress economic growth.

After mid-1955, however, the price level began to creep up. From mid-1955 to mid-1958, the price level rose by an average of about 2½ percent a year. This creeping rise of the price level was termed America's major problem. The campaign for restrictive policies was intensified, although economic slack was prevalent. The administration fought the creeping price level with the restrictive tools that were more appropriate to combatting war-related, sharp price boosts in times of shortages.

In an attempt to put the creeping rise of the price level in perspective, Prof. Alvin H. Hansen of Harvard University has pointed out that the record for the years 1948–58, including the post-Korean inflation, "is by no means an irresponsible record," by comparison with price level trends since 1897. If we start with 1913, when the Government first published the Consumer Price Index, we find that between 1913 and 1948, consumer prices increased by an average

yearly rate of 2.6 percent; from 1948 to 1958 consumer prices increased by an average yearly pace of 1.8 percent.

This record of an upward creep of the price level has been distorted into a springboard for a continuing national campaign to suppress economic growth and to weaken organized labor. Economic growth and trade unions have been singled out by the Government and business spokesmen as inflation-producing villains.

Industrial costs and prices

Although factory workers have borne the brunt of the attack—wage increases have been blamed for the rise of prices—payroll costs of factory production and maintenance workers per unit of output have actually been relatively stable in recent years. The rise of wholesale industrial prices, while unit payroll costs of factory production and maintenance workers have remained relatively stable, cannot possibly be explained by wage increases, except as part of a propaganda attack against organized labor.

	Payroll costs of factory production and maintenance workers per unit of output	Wholesale industrial prices
1953	108.9	114.0
1954	106.7	114.5
1955	105.4	117.0
1956	107.6	122.2
1957	108.5	125.6
1958	107.0	126.0
1959	105.7	128.2

NOTE.—1947–49=100.

Source: Wholesale Prices, Department of Labor; unit payroll costs computed from Federal Reserve Board and Department of Labor.

In 1959, for example, unit payroll costs of factory production and maintenance workers were almost 3 percent below 1953 and about the same as in 1955, while wholesale industrial prices were 13 percent above 1953 and some 10 percent greater than in 1955. Even if nonpayroll fringe-benefit costs were added to payrolls, estimated total unit costs of factory wage workers, in 1959, were no greater than in 1953 and approximately 2 percent above 1955. The attempt to pin the blame for the creeping price level on industrial wage earners and their unions is simply a tissue of falsehoods.

As Gardiner Means has shown, the rise of industrial prices at the wholesale level in recent years has centered mainly in the administered-price industries. Price increases for key industrial goods were facilitated by the capital goods boom which started in 1955 under the stimulus of Government tax policies, although experience during the 1958 recession shows that such a boom is not a necessary condition for increases in administered prices. Price boosts for steel and other capital goods, during the last few years, spread throughout the economy and created a general business climate favorable to price raising.

In his "Recent Inflation in the United States," which was prepared for this committee, Prof. Charles Schultze states:

"If the rise in prices (in 1955–57) was not a result of an overall excess of monetary demand, neither was it primarily caused by an autonomous upward push of wage rates. There are many indications of this. For example, the capital goods and associated industries accounted for two-thirds of the rise in industrial prices during this period, but in these same industries prices rose substantially more than wage costs. Profits per unit of output rose in the capital goods industries, although for the economy as a whole they declined."

The key capital goods industry is steel, an administered price industry that is dominated by United States Steel. Successive price boosts for steel and steel products, after mid-1955, raised unit profit margins and reduced the industry's break-even point.

According to Professor Schultze, United States Steel set prices, between 1920 and the mid-1950's, to obtain after-tax profits of 8 percent on net worth when operations were at 80 percent of capacity. But, starting in 1955, Professor

Schultze indicates, United States Steel set prices to yield a 12 percent to 13 percent rate of return on net worth when operating at 80 percent of capacity. The Senate Subcommittee on Antitrust and Monopoly has revealed that the steel industry's successive price boosts and rising profit margins have reduced the industry's break-even point to only 40 percent or less of capacity.

Price rises for steel and other capital goods applied upward pressures to the entire price level as they spread through the economy. But that is only part of the story of recent industrial costs and prices.

While business investment boomed from mid-1955 to mid-1957, the rest of the economy slowed down considerably, under the impact of the Government's economic squeeze. The addition of new capacity and certain factors associated with rapid technological change, while production lagged, increased unit industrial costs considerably.

The capital goods boom, for example, resulted in a sharp rise of depreciation charges, which were spread over a slowly increasing number of units produced, since output and sales increased only very slowly. It therefore resulted in a sharp rise of depreciation charges per unit of output. Professor Schultze estimates that depreciation charges per unit of manufacturing output rose over 40 percent between 1953 and 1957 and almost 20 percent between 1955 and 1957.

The capital goods boom and rapid technological change were accompanied by a sharp rise in research and development outlays and in a sharp increase in management's hiring of scientists, engineers, technicians, and supporting staffs. The cost of an enlarged salaried personnel was magnified by the additional cost of salary increases. These sharp rises in total salary payments were spread over a slowly increasing volume of output, in a period of slowly rising production and sales. They resulted, therefore, in a sharp rise of salary costs per unit. Professor Schultze estimates that salary costs per unit of output in manufacturing rose almost 36 percent between 1953 and 1957 and about 22 percent between 1955 and 1957. He states:

The largest part of the rise in total costs (in manufacturing) between 1955 and 1957 was accounted for not by the increase in wage costs but by the increase in salary and other overhead costs. This increase in turn was associated with the investment boom. Business firms purchased large amounts of new equipment, hired extensive professional, technical, sales and clerical staffs, and speeded up research and development projects.

"More than half of the total increase in costs is accounted for by higher salary costs per unit and three-quarters by salaries and depreciation together."

The problem of course resides not in the expansion of salaried staffs or in the rise of salaries, but in the failure of production to increase sufficiently to offset the effect of these factors on unit costs.

Manufacturing firms tried to pass these substantial cost increases on to their customers through price rises. In most industries where there are some degrees of price competition, companies raised prices, but not as much as they would have liked to do. In many industries, therefore, there were small declines of profit margins.

In other industries where prices are administered, such as automobiles, successive price boosts maintained or increased profit margins. Through its system of administered prices, the auto industry, which is dominated by General Motors, was able to raise its prices, despite the drop of auto sales and production after 1955.

The auto industry's price leader, General Motors, sets prices according to the Senate Antitrust and Monopoly Subcommittee, to produce a 20 percent after-tax rate of return on net worth, when utilizing its capacity the equivalent of 180 days a year.

The recent hearings of the Senate Subcommittee on Antitrust and Monopoly, regarding the price of vital drugs, indicates the power of administered-price industries to obtain huge markups and tremendous rates of return on investment.

Prices of services and foods

Part of the pressures from price increases for basic industrial goods was absorbed by more competitive manufacturing industries, wholesalers and retailers, through rising productivity or reduced profit margins. In some cases, profit margins of smaller manufacturing companies and retailers were squeezed between the price increase of key, administered-price supplier industries and competition for customers. Profit margins of auto dealers, for example, fell after

1955, as auto manufacturers raised their prices and intensive retail competition developed in a market whose sales were declining.

Most of the direct pressure on consumer prices, therefore, did not come from the retail prices of industrial goods, but from other consumer purchases, such as services.

To some extent, rising prices of services—such as medical care, hospitalization, auto insurance, repairs—have reflected increases in the prices of steel, machinery, autos, and trucks. But most of the rise of these prices has resulted from population growth, the spread of home ownership and suburban living, with increasing consumer demand for services that are not easily mechanized.

Retail food prices have also risen in this period—largely due to a combination of factors, including crop and weather conditions, as well as the price and profit policies of the dominant packing and processing companies in several key food industries.

Steps toward achieving price stability

A freeze on wage increases, in an economy with rapidly rising output per man-hour, which many political and business spokesmen seem to advocate, will not and cannot solve the problem of an upward creeping price level. While low wages would reduce unit costs, there is no assurance that prices would decline, and that profit margins would not rise substantially. Furthermore, low wages would bring a collapse of important consumer markets and a declining economy.

In addition, a freeze on wage increases would not necessarily even offset increases in other costs, such as depreciation, salaries, and other overhead. Since 1955, for example, the additional unit costs resulting from increased depreciation charges and salary payments could have been offset only by wage cuts for production and maintenance workers, at the levels of production actually experienced.

The attack on unions and collective bargaining is cloaked in terms of a noble crusade against inflation. But if this attack is successful, it will pull down the entire economy, with no assurance whatsoever, of price stability. The collapse of 1929, which followed a period of rapidly rising productivity and slowly rising wages, should be ample proof of the danger of slowly rising consumer buying power, in an economy whose productive effciency is increasing rapidly.

On the basis of the known facts, a major step toward achieving a reasonably stable price margin would be a faster and more balanced rate of economic growth than we have had in recent years.

The business investment boom of 1955–57 was out of balance with lags and declines in most of the rest of the economy. It was this one-sector business investment boom that established the basis for the creeping rise of the price level after mid-1955. A reasonably stable price level requires a much better balance between sales and business investment, with a closer relationship between both rising sales and rising productive capacity.

A faster pace of balanced economic growth is a basic requirement for reasonable price stability. When output is rising rapidly, productivity rises rapidly, too, and unit costs of depreciation, salaries, and other overhead tend to be low. It was the slowdown of economic growth, in a period of booming business investment, sharply rising research and development and management's attempt to recover all costs quickly that caused most of the rise in industrial costs and prices between 1955 and 1958. A much faster rate of economic growth is needed, if reasonable price stability is to be achieved—to minimize the impact of rising costs of technological change, business investment, research and development, and other overhead.

The pricing policies of business generally, and the major industries particularly, should be changed so that rising profits would come from an expending volume of sales, based on low prices and low profit margins on each item, rather than from high prices and large profit margins that curb the continuing growth of sales.

The Government can be of significant help by assisting in the development, with union and employer cooperation, of increased productive efficiency and reduced costs in low-productivity industries. Such industries are usually composed of small firms that cannot afford concentrated research efforts.

Government can be of help, too, in stabilizing prices of some services by assisting in the increase of the supply of services. A comprehensive government effort in the area of health and medical care, for example—by increasing the number of physicians, dentists, nurses, medical technicians, hospitals and convalescent homes—could begin to stabilize medical care costs.

The President's Economic Report states:

"Hourly rates of pay and related labor benefits can, of course, be increased without jeopardizing price stability. Indeed, such increases are the major means in our free economy by which labor shares in the fruits of industrial progress. But improvements in compensation rates must, on the average, remain within the limits of general productivity gains if reasonable stability of prices is to be achieved and maintained. Furthermore, price reductions warranted by especially rapid productivity gains must be a normal and frequent feature of our economy. Without such reductions we shall not be able to keep the price level as a whole from advancing."

This statement in the President's report is similar, in the main, to numerous AFL-CIO statements over the years. But the President, unfortunately, has not seen fit, in the 7 years of his administration, to do anything that would help to stabilize the prices of industries with "especially rapid productivity gains," let alone doing anything to assist in achieving price reductions in such industries. Most of the industries with especially rapid productivity advances are also industries in which there is little effective price competition and prices are set by the executives of the dominant firms to produce large profit margins.

The focus of public attention on the cost-price-profit-investment policies of key industries—such as the current hearings on drug prices by the Senate Antitrust and Monopoly Subcommittee—would be helpful in stabilizing, and perhaps, in reducing prices of such industries, whose productivity is rising rapidly and whose profit margins are excessively great.

In attempting to get at the price pressures created by the pricing policies of the dominant corporations in strategic parts of the economy, I proposed to the Senate Subcommittee on Antitrust and Monopoly the idea of attempting to compel such companies to publicly justify price increase. I suggested for my own union, the UAW, that any company which controls, say, more than 20 or 25 percent of the sales in its industries should be required to give advance notice and public justification of the price increases it proposes to put into effect, through a public hearing before a Government agency which would have access to all the relevant facts, and after the hearing would publish the facts as they had been brought out.

As I said in the subcommittee's hearings 2 years ago, "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."

POLICIES FOR BALANCED ECONOMIC GROWTH

America needs a decisive change of economic policies. Balance and growth must be substituted for restrictive and unbalancing policies. National issues must be placed in proper perspective, on the basis of reality. Priorities must be established so that the Government and the American people may move forward with an adequate sense of the social and moral values of national issues. First things should be put first and the Nation's resources should be committed to achieve national priorities. Goals should be set as an inspiration to America and as targets for progress.

We have followed policies of stagnation and restriction so long that the social deficits and unmet national needs cannot possibly be fulfilled in a few months or even years. A beginning should be made immediately, however, to meet our needs.

A balanced and growing, full-employment economy is urgently needed—to provide the extra margin of rising national production for adequate national defense, public services for a growing population, social and economic adjustments to automation and rapid technological change, the elimination of poverty in the United States and economic and technical aid for the less-developed uncommitted nations of Asia, Africa, and Latin America.

Unless we can achieve the additional margin of a more rapid and more balanced economic growth in the years ahead, America will face increasing troubles at home and abroad. National needs must be met in the light of the requirements of the second half of the 20th century.

1. Balanced economic growth of 5 percent a year and full employment should be established as the goal of national economic policy. At the beginning of each year, the President's Council of Economic Advisers should present to

Congress and the American people the objectives that should be sought, in each major part of the economy, and the policy guidelines to sustain balanced economic expansion of 5 percent a year and full employment.

2. A halt to the Government's tight-money squeeze and high interest rates is essential if the economy is to achieve a more rapid pace of economic growth. An adequately expanding money supply is required to support a growing full-employment economy. Lower interest rates must be achieved to encourage economic growth.

The Federal Reserve Act should be amended to provide for adequate representation of consumer, small business, and labor interests on the governing and advisory bodies of the Federal Reserve Bank System, which is now dominated by the viewpoint of bankers and big business.

3. Attempts to balance the Federal budget at relatively low levels of production, incomes, jobs, and Federal tax revenues have proven to be self-defeating. Needed defense and public service programs should be judged on the basis of national and social needs, rather than on the sole basis of budget balance. The Government's budget policy should be geared to a more rapid rate of economic growth, to produce budget balance and surplus as a result of rising tax revenues from the increasing output, sales and incomes of a rapidly growing economy.

4. The Federal Government's tax structure is in need of substantial revision to provide a more equitable means of raising required tax revenues. Top priority in such revision should be given to closing loopholes of special tax privileges to wealthy families and corporations and to reducing the tax burden on low- and middle-income families.

As much as $9 billion of additional revenue can be raised if these numerous loopholes were closed. The following immediate steps in this direction could raise about one-third or more of that additional revenue.

(*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 measures to close tax loopholes can raise sufficient revenue to cover a reduction of the tax burden on low- and middle-income families, as well as increases in Federal expenditures that are needed to meet the Nation's crucial needs.

5. Comprehensive and national programs—with Federal leadership, direct financial aid, grants-in-aid to the States and long-term low-interest loans—are required to begin to meet the needs of a growing population in education, housing, health, urban redevelopment, community facilities, the conservation and development of natural resources.

Such efforts have been restricted and starved for much too long. America must move ahead with comprehensive efforts to meet the public-service needs of a growing population.

6. The national defense effort is in urgent need of a careful examination in terms of the requirements for the defense of the United States and the free world. Defense expenditures should be raised, if necessary, to provide adequate national defense.

7. A better and more continuing balance is needed between the economy's ability to produce and its ability to consume. That means continuing improvements in wages and salaries—to boost consumer buying power, which is the basis of mass markets—in an economy whose ability to produce is increasing rapidly.

Special efforts are needed to lift the buying power of low-income families—through amendments of the Federal minimum wage law, for example, to extend the law's coverage to millions of unprotected low-wage workers in retail and wholesale trade, services and large-scale farms and to raise the minimum wage to $1.25 an hour.

8. The Government must be prepared with antirecession measures, to move promptly and decisively, should another recession occur. A comprehensive and

detailed, national shelf of public-works programs should now be planned and blueprinted to be put into operation at the very start of an economic decline.

9. The unemployment insurance system should be permanently improved by additional Federal standards to extend the duration and to raise benefit payments to unemployed workers. Restrictive eligibility requirements and harsh disqualification provisions also should be removed.

10. The Social Security Act should be amended to provide increased benefits and hospital and medical care protection for those who are eligible for old-age and survivors' benefits.

11. With the increasing number of economically distressed communities and the spreading tendency of firms to shut down old plants and to build others in new areas, Federal Government assistance for economically distressed communities is essential—to attempt to attract businesses to establish new operations in such areas, to retrain workers in new skills and to assist businesses in such communities to change their production for markets that are expanding.

12. Economic and technical aid for the peoples of the less-developed countries, who are emerging from colonial domination, should be considered as a major aspect of national policy by the United States, in cooperation with the industrial nations of Western Europe and Japan.

13. Through amendment of the Fair Labor Standards Act, as well as through collective bargaining, a progressive reduction of the standard workweek should be achieved in the years ahead, as the advance of technology reduces manpower requirements.

14. This committee of the Congress has already made a start in investigating the social and economic effects of rapid technological change. Much more information and examination of varying policy proposals are needed. A permanent, national commission on technological change, composed of representatives of labor, farmers, management, and consumers, should be established to keep under continuing review the developments in automation, atomic and solar energy and other technological innovations, and to make recommendations to Congress and to the President to assure that the fruits of technological advance are fairly shared and full employment sustained. The Commission, too, should provide a periodic review of the standard workweek in relation to changing technology.

15. Opportunities should be opened for members of minority groups to contribute fully to and share fairly in social and economic progress through enactment of Federal fair employment practices legislation.

16. International economic and trade policies of the United States require bold and realistic measures to meet the needs of the times. The United States must improve 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 General Agreement on Tariffs and Trade and the International Labor Organization, the creation of international fair labor standards provisions on wages and other labor conditions in export industries, directed at rising wages in such industries, step by step, to levels justified by productivity.

The United States should also pursue, along with the industrial nations of western Europe, the development of practical solutions to national problems created by changing balances of international payments among nations, due to changes in the levels of exports, imports, investments, and financial assistance.

17. A continued national investigation and analysis of the price structure is needed—such as the work that has been ably begun by the Joint Economic Committee and the Senate Subcommittee on Antitrust Monopoly—to provide the basic facts and knowledge for developing possible remedies, in the framework of a rapidly growing economy.

All parts of the national economy should be examined in detail, in an attempt to isolate and analyze the specific causes of a slowly rising price level. Public attention should be focused on the pricing policies of the dominant corporations in major industries, whose prices are administered by the executives of the big corporations, rather than determined by effective price competition. Each part of the economy should be examined in detail, for the possible development of reduced profit margins and improved productive efficiency.

Above all, American needs leadership, direction, and a restatement of national goals. A firm faith in the future of a free society is required to change the course of national policy from complacency, neglect, and stagnation to growth and progress.

America has the human resources, the skills and ingenuity, the productive power, and democratic traditions that are needed. No nation is better equipped to meet the new and challenging responsibilities that have been thrust upon us, as the custodians of human freedom.

What we need most of all is a decisive change to national policies that are firmly rooted in an optimistic faith in America's ability to solve its many problems and to move forward as a powerful and free society.

Mr. RUTTENBERG. I will try to hold my remarks so that I might finish by 10:30 or 10:35 so there will be plenty of time for questions. I look at my watch and see it is 10 past 10.

The CHAIRMAN. We are nearly 12 minutes late starting so we should not adjourn until quarter past 12, so you should take a full half-hour which might bring you slightly before quarter of 11.

Mr. RUTTENBERG. Very good, sir.

I would also like permission, if I might, to insert into the record a statement adopted by the AFL-CIO economic policy committee at their meeting here in Washington on Monday, January 25. It is a statement commenting upon President Eisenhower's annual Economic Report and the budget message submitted to Congress. If I might have that inserted in the record I would appreciate it.

The CHAIRMAN. That will be done.

(The statement referred to follows:)

[News from the AFL-CIO, for release, morning papers, Tuesday, Jan. 26, 1960]

The AFL-CIO economic policy committee meeting in Washington Monday, adopted the following statement on the President's Economic Report and budget message:

President Eisenhower's Economic Report to the Congress sets forth three basic economic objectives for the coming year. All three are designed to stem a "phantom" inflation instead of designed "to use all practical means to * * * foster and promote * * * maximum employment, production and purchasing power," as stated in the Employment Act of 1946.

The President's three proposals for the coming year are (1) adopt his budget, (2) use the surplus revenue over expenditures to reduce the debt, and (3) remove the interest ceiling on long-term Government bonds.

In his budget message to the Congress, which preceded his Economic Report by only 2 days, he said, * * * "I invite the Congress to join with me in a determined effort to achieve a substantial surplus."

The two messages fail to grapple with the fundamental problem facing the American economy, namely, that a full year after the end of the recession, 5 percent of the labor force is still unemployed and almost one-fifth of the Nation's productive capacity still lies idle.

Maximum employment, production and purchasing power cannot be obtained by squeezing the economic system and slamming on the brakes to stop economic growth as is proposed in both the Economic Report and the budget message.

Success of the President's economic program can mean only an economic slowdown. The present inventory buildup will ease after midyear. The danger of another recession in 1961, before America fully recovers from the ravages of the sharp 1957-58 decline, seems a distinct possibility as predicted by conservative academic and business economists.

The President's economic messages, are not a promise of faith in America's capabilities for progress. They are a promise, rather, of continuing stagnation, which has cut down the growth of per capita national production, since 1953, to merely six-tenths of 1 percent a year. This is approximately one-seventh the rate of the Soviet Union's economic advance.

First among the President's economic goals is adoption of his budget proposals for 1961. There is an increased obsession with achieving a budget surplus. A balanced and growing full employment economy, rather than a stagnated economy, is the only practical means of attaining budget surpluses.

The President's budget proposals are a continuing blend of pennypinching for national defense and public services, coupled with increases for postal rates and gasoline taxes. Programs to meet national needs are minimized or ig-

nored in order to produce a budget surplus on paper, which, in fact, has been actually achieved in only 2 of the past 6 budget years of this administration.

These are the same self-defeating policies, which have increased the national debt by more than $18 billion since mid-1953, while America's world position in defense technology has slipped and its education system has continued to deteriorate. Seven years of obsessive concern with budget balancing have produced the greatest peacetime increase of the national debt. This emphasis upon holding down the rate of economic growth rather than attaining an annual sustained 5 percent rate has produced just the reverse of what this administration has been attempting to accomplish.

According to administration plans, national defense expenditures for the coming year will remain static. Many experts believe that America's present defense posture is inadequate to meet the needs of the Nation and the free world.

Merely a token gesture of Federal aid for school construction is proposed, with no mention of assistance for teachers' salaries. State and local governments, many of which are reaching the end of their financial capabilities in the field of education, are told that they "will have to redouble their programs to provide teachers and equipment for secondary and higher education," with no promise of a comprehensive program of federal assistance.

The second of the President's major objectives is to use the $4.2 billion paper surplus in 1961 for reduction of the national debt. This paper surplus, however, is based upon sweeping under the rug the need for comprehensive defense and public-service programs.

A budget surplus is obviously a worthwhile goal. It cannot however be achieved by curbing the growth in production, sales, incomes and jobs. Neither should a budget surplus be considered the major goal of national policy when it is achieved at the dangerous cost of ignoring national needs.

The budget deficits of 1954, 1955, 1958, and 1959 are a clear indication that surpluses cannot be attained from recurring recessions and relatively low levels of national income.

A responsible budget policy would aim for budget surpluses that arise from a growing and balanced full employment economy, and not from an economy in which about 5 percent of the labor force remains jobless.

The President's third major economic policy objective is a request that Congress remove the present 4¼ percent ceiling on interest rates for long-term Government bonds. This action would eliminate even a limited restriction on the administration's pursuit of an ever-tighter money policy and higher interest rates.

With the Federal Reserve System's rediscount rate at 4 percent and the prime interest rate for the wealthiest borrowers at 5 percent, interest rates for homebuyers, small businessmen, farmers, and consumers generally are now 5½, 6, or even 7 percent. These are the highest interest rates in over a quarter of a century.

The tight money policy has already brought a slump in homebuilding. It threatens to slow down the entire economy after midyear. Further increases in interest rates, without any limitation, could only aggravate this condition and underscore the possibility of another recession next year.

What America needs is not a continuation of restrictive budget and monetary policies, which have brought on two recessions and economic stagnation in the past 7 years. America requires positive Government efforts to meet the needs of a growing, urban population, in the world of the 1960's. To support such efforts, while improving the living conditions of the American people, particularly low-income families, America needs maximum utilization of available labor and resources.

We urge the Congress to reject the administration's dangerous policies of ignoring national needs and curbing economic progress.

In this first year of the new decade, it is organized labor's fervent hope that the Federal Government will provide America with mature leadership in attaining a strong, full production—full employment economy that will be capable of meeting the needs for adequate national defense and public services, while lifting the living standards of the American people.

Mr. RUTTENBERG. If I might at the outset call your attention to a set of charts which I think have been distributed to each of the members of the committee, I would like to comment briefly upon them.

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These charts are based upon facts and figures and tables that are contained in Mr. Reuther's testimony. I should like to run briefly through these six charts for you at the outset to set the tone and background of what the entire document of Mr. Reuther and what I intend myself to say this morning.

If we look at the very first chart, the national production deficit, the dark line from 1947 to 1953 is the actual gross national product in 1959 dollars.

The CHAIRMAN. These figures are taken from the Council of Economic Advisers?

Mr. RUTTENBERG. Yes, sir. The dark line and the bottom line, not the checkered line on the top. The bottom line up through 1953 reflects the growth rate of the economy in dollars converted on an annual growth rate to 4.7 percent. The rate for 1953 to 1959 as shown is 2.3 percent.

If we were to have moved forward through the 1953–59 period at the rate of growth taking place in the previous period from 1947 to 1953, we would have had a gross national product at the end of 1959 somewhere in the neighborhood of $550 billion; instead, we had a gross national product of roughly $480 billion or so in 1959.

This is a cumulative loss of $260 billion in gross national product, that if converted just in terms of what the Federal Government would have gotten in revenue, we could have raised $50 billion additional revenue from this loss in national product.

I might point out that in this latter period the growth was 2.3 percent. The Soviet growth rate in this period was somewhere, depending upon whose estimate you take, in the neighborhood of 6, 7 or 8 percent.

So we were running substantially behind the Soviet race. If I might pass on to the second chart and call your attention to the putting of the gross national product on a per capita basis, taking into consideration now the growth rate as it relates also to the growth in population.

Here we find an average annual per capita increase of 3 percent in the period 1947 to 1953, with an average annual per capita increase in the period 1953–59 of six-tenths of 1 percent. This growth rate in the last 7 years is one-seventh of what the growth rate in the Soviet Union has been on a per capita basis.

The per capita growth rate in the Soviet Union is somewhere around 4½ percent. Our growth rate has been six-tenths of 1 percent.

Might I call your attention to the third chart, which is headed "Unemployment as a Percent of the Labor Force." I might say, Mr. Chairman, that I assume that these charts might be reproduced in the record during the course of the discussion.

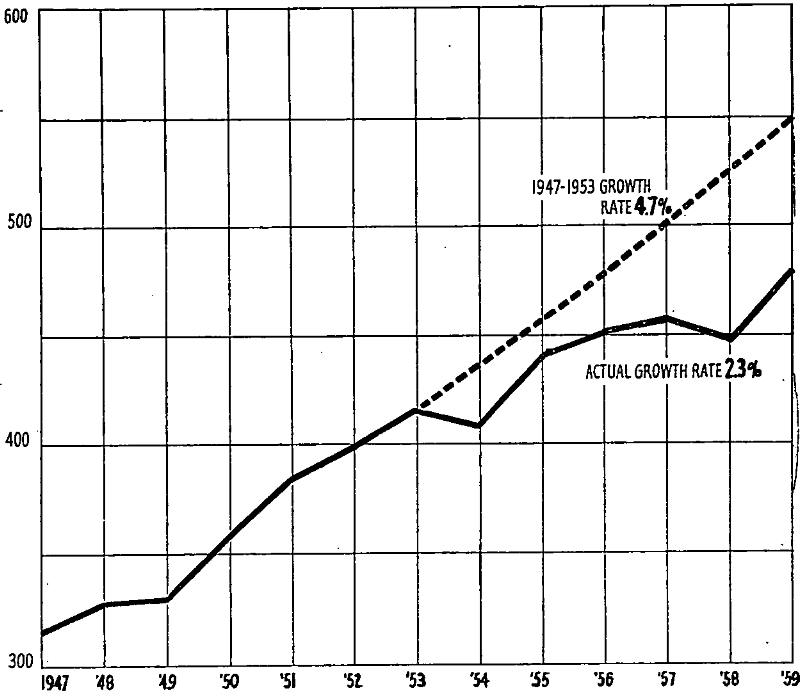
The CHAIRMAN. That will be done. This chart, as a matter of fact, was included in the majority report which was issued last week.

Mr. RUTTENBERG. Yes; I understand it was.

(The charts referred to follow:)

National Production Deficit GROSS NATIONAL PRODUCT IN 1959 DOLLARS

BILLIONS OF DOLLARS

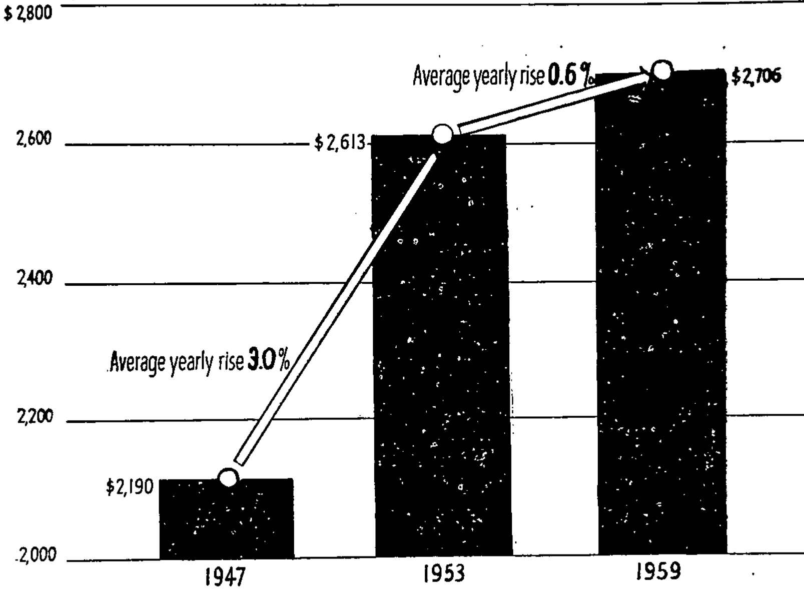


1953-1959 LOSS OF PRODUCTION · $260 BILLION

1953-1959 LOSS OF FEDERAL REVENUE · $50 BILLION

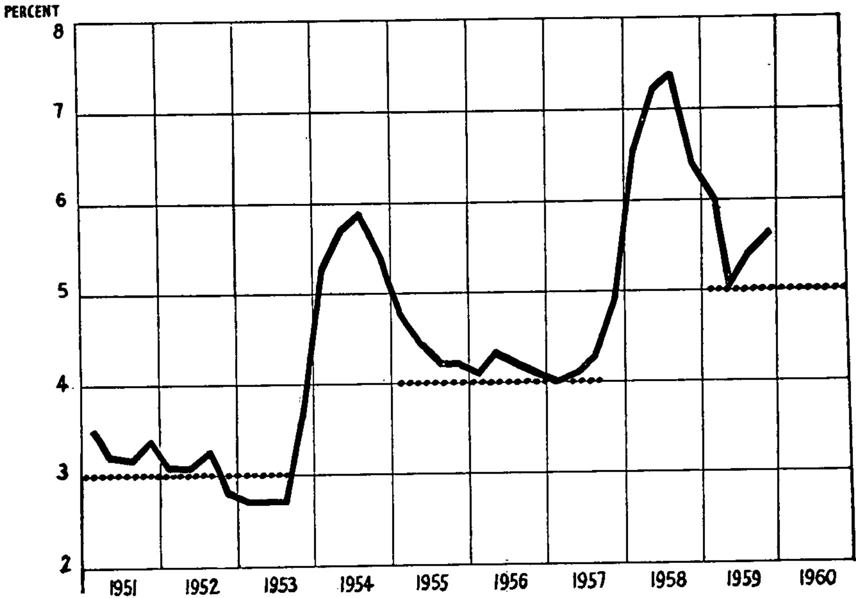
SOURCE: COUNCIL OF ECONOMIC ADVISERS

Six Years of Near-Stagnation, 1953-1959



SOURCE: COUNCIL OF ECONOMIC ADVISERS AND CENSUS BUREAU

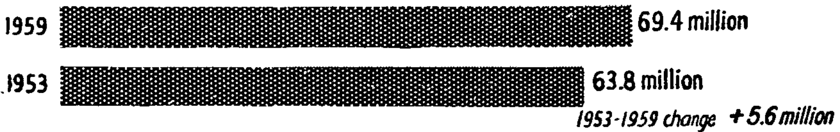
Unemployed as Percent of Labor Force



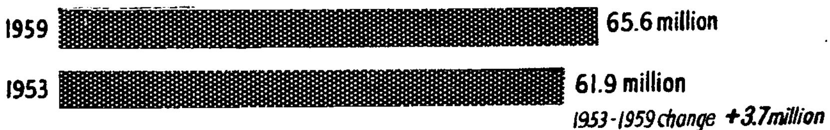
SOURCE: U.S. LABOR DEPARTMENT

Changes in Employment and Unemployment, 1953-1959

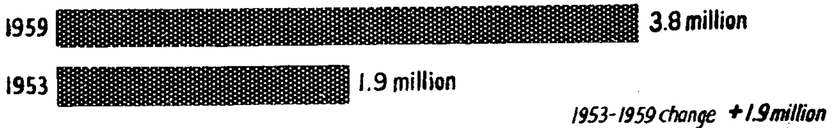
LABOR FORCE



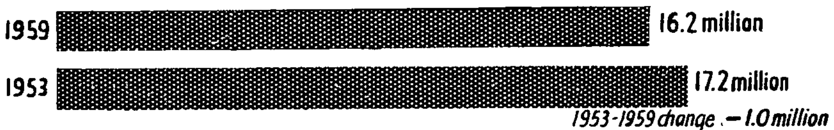
EMPLOYMENT



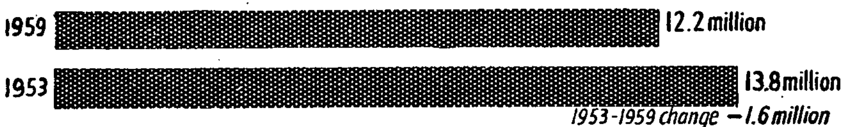
UNEMPLOYMENT



TOTAL MANUFACTURING JOBS

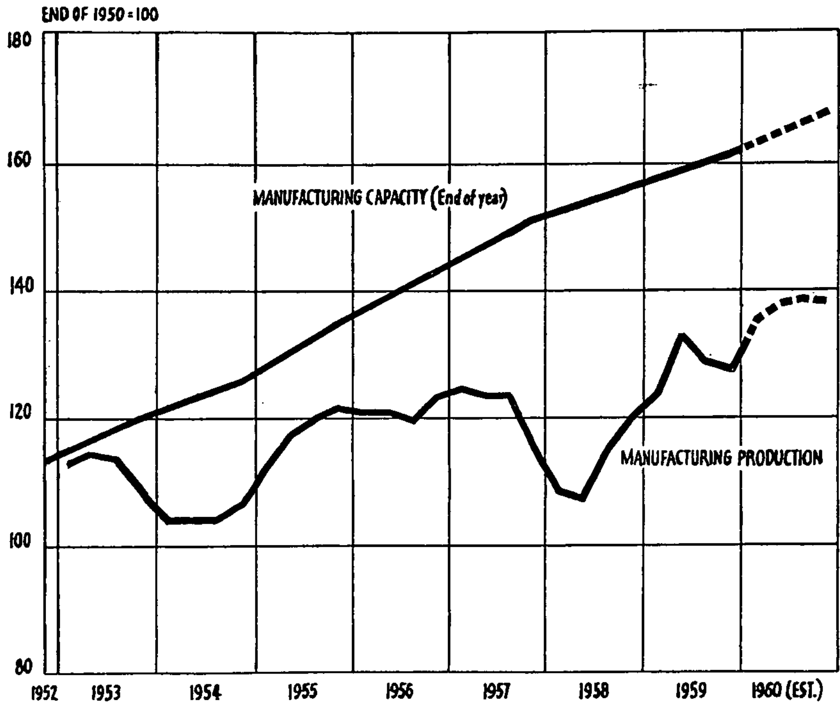


MFG. PRODUCTION & MAINTENANCE WORKERS



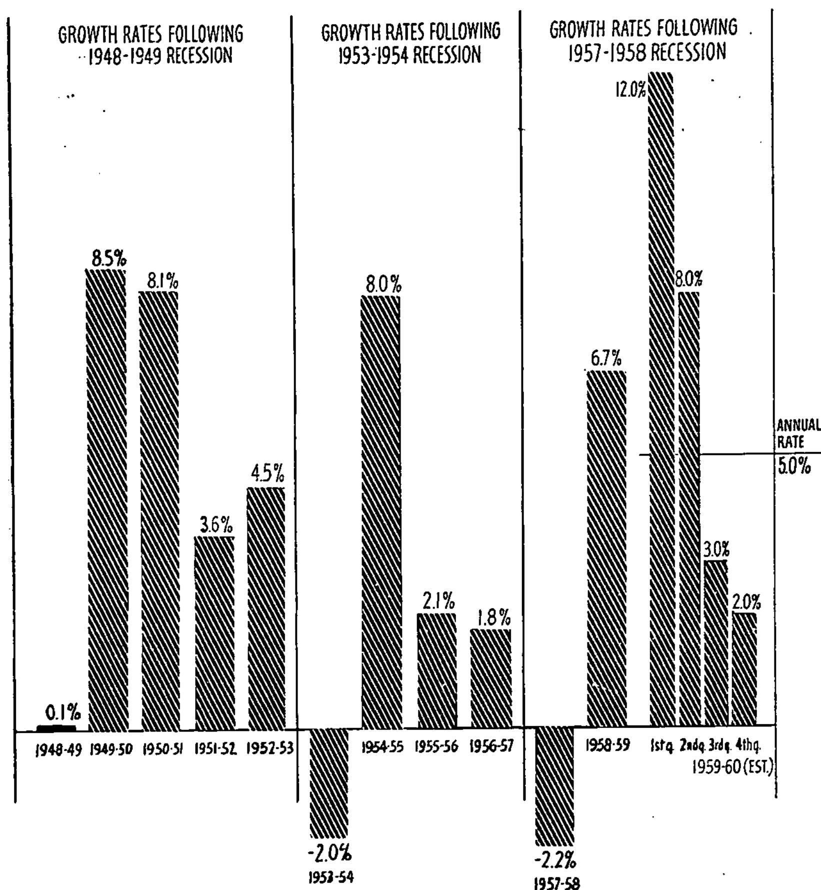
SOURCE: U.S. DEPARTMENT OF LABOR

Manufacturing Capacity and Production, 1953-1959



SOURCE: FEDERAL RESERVE BOARD AND McGRAW-HILL PUBLISHING CO.

Economic Growth Rates Following Recessions



GROSS NATIONAL PRODUCT IN CONSTANT 1959 DOLLARS

SOURCE: COUNCIL OF ECONOMIC ADVISERS

Mr. RUTTENBERG. This, I think, is a very interesting chart and I think it is almost self-explanatory. It begins in 1951. It begins at the period following the 1949–50 recession. We had there a leveling off of unemployment as a percent of the labor force in the neighborhood of about 3 percent prior to the 1954–55 recession.

We get to 1954–55 recession, the unemployment rate touches almost 6 percent and we get a leveling off after that at about 4 percent. Then we get the 1958–59 recession with unemployment touching upward of 7.2 or 7.3 percent and then a leveling off in 1959, about at 5 percent, but it looks like in November 1959 the unemployment rate was 5.6 and in December it was 5.2 and what it will be during 1960 I do not know.

I am going to have some comments to make about that in a moment. It looks to me it will level off in the neighborhood of about 5 percent.

So we go through one recession after another, ending up with a level unemployment higher than the preceding one. I think that is quite significant.

Part of this problem is due to what is seen on the next chart, changes in employment and unemployment in the period 1953–59. Here we show during the past 7 years a growth rate in the labor force of 5.6 million people. A growth rate in employment of 3.7 million. The resultant effect of this is that unemployment has grown by 1.9 million, or roughly 100 percent, because unemployment was 1.9 million in 1953 and now it is up to 3.8 million in 1959.

I think the important part of this table is to indicate that yes, we have had growth. We have had rises in employment during the past 7 years. This is important and we have to recognize it. But the growth rate in employment opportunities has not been sufficient to absorb the increase in the total number of workers that are coming into the labor force each year.

Now, it might be interesting to look at the last two sets of bars on that table that shows that employment in manufacturing has dropped by a million in the past 7 years and employment in factory production and maintenance jobs has dropped by over a million and a half in the last 7 years.

The next chart is manufacturing capacity and production, 1953–59. These are figures based upon McGraw-Hill's estimates upon what manufacturing capacity is. That is the top line. The bottom line, manufacturing production, is the Federal Reserve Board's index of production for manufacturing, with the 1959 and 1960 figures, the yearend figure 1959 being an estimate of our own, AFL–CIO, while the 1960 figure is also an estimate of our own.

The difference between productive capacity in manufacturing and actual production at the end of 1959 was 16 percent. In other words, 16 percent of our productive capacity was unused at yearend 1959.

Now, I think the last chart that I have in this set of illustrations is indicative of the problem that I want to talk to this morning. I think it illustrates really one of the problems that we have, and that is the annual growth rate in GNP in the years following each of the three recessions that we have gone through in the past 10 years.

The 1948–49 recession showed almost a stable level of gross national product. Then we see in the following years what happened and the same for the 1953–54 recession, a drop of 2 percent in GNP, with the growth rates following that, and then the period of 1957–59 with a drop of 2.2 percent in GNP and the growth rates of 1958–59 shown there.

I want to explain the last four bars because I think this is the key to the problem we are going into in the year 1960. The annual first-quarter rate of growth of GNP on an annual basis will be about 12 percent over the fourth quarter of 1959 or a 3-percent rise, quarter to quarter. The growth rate in the second quarter over the first quarter of 1960 will be on an annual rate of about 8 percent, while moving into the third quarter the annual growth rate will probably be at about 3 percent, and into the fourth quarter about 2 percent.

The CHAIRMAN. I know one question that will be asked you is whether the growth rate for the third and fourth quarters was not held back by the steel strike.

Mr. RUTTENBERG. These figures on the right, the four bars on the far right of this chart, are indications of what might happen in the four quarters of 1960 over 1959. It is true that if we go into 1959, certainly the growth rate was held back in the third quarter because of the steel strike, and well into the fourth quarter, because the steel strike continued until mid-November.

Representative CURTIS. The source of that is not the Council of Economic Advisers.

Mr. RUTTENBERG. The source of all of these figures up until we have 1959–60 certainly are the annual growth figures which are based upon the growth national figures of the Council of Economic Advisers.

Representative CURTIS. I was asking you about the last three.

Mr. RUTTENBERG. The last four bars are our own estimates and are clearly marked.

Representative CURTIS. I question whether this chart should have on it "Source: Council of Economic Advisers."

Mr. RUTTENBERG. The source of the national product figures is the Council of Economic Advisers.

Representative CURTIS. I understand that. But not the source of this chart or these last three things. It creates an erroneous impression. They are not their estimates.

Mr. RUTTENBERG. They are not their estimates. It ought to be more clearly marked that they are estimates of mine, the AFL–CIO, but the fact that the annual rate of 5 percent which is the line drawn across 1960, that is the rate estimated by the President in his budget message and by the Council of Economic Advisers in their report.

The growth rate in 1960 will be roughly about 5 percent. I have tried to put what that 5 percent will look like on a quarterly basis. We will get most of that growth in the first quarter, a little more in the second quarter, but by the time we get into the third and fourth quarters of 1960 we will be increasing gross national product at a much more limited rate. That is the point I want to make.

Representative CURTIS. So the 5 percent is their estimate?

Mr. RUTTENBERG. If I might go to the next comment, I think I will get to the point you are at because I intend to comment specifically upon the President's estimate.

The CHAIRMAN. Let us clear up one of these points. On page 155 of the report of the Council I notice that they give not merely annual figures, but quarterly figures of gross national product.

Have you used those quarterly figures for 1959?

Mr. RUTTENBERG. Yes. All of the figures, Senator, up to the last four narrower bars are based upon the actual figures of the Council of Economic Advisers on gross national product.

It is just the last four bars which really should be labeled "1960" and not "59–60."

The 12 percent figure for the first quarter is the 12 percent growth rate, annual rate, in the first quarter of 1960 over the fourth quarter of 1959 or a 3 percent rise, quarter to quarter.

Representative CURTIS. That is pretty good. Not over the year; just over the fourth quarter.

Mr. RUTTENBERG. Yes. The growth rates per quarter. So that the second quarter figure of 8 percent is an annual percent of annual growth rate over the first quarter of 1960. So that the growth rates,

fourth quarter to first quarter, second quarter to third, second to third and third to fourth are these four bars which show a declining rate of growth.

The CHAIRMAN. What is your estimate of the gross national product for 1960?

Mr. RUTTENBERG. For 1960 on a current price of about $510 billion, which is the figure the President used on his budget and on a real base, probably about $505 billion in 1959 prices.

The CHAIRMAN. That is an allowance of 1 percent for an increase of prices?

Mr. RUTTENBERG. That is right.

The CHAIRMAN. That squares with the estimate of the Secretary of the Treasury, and also the informal estimates which we had on Monday from the various technicians whom we had before us.

Representative CURTIS. I think they were a little more optimistic than the Council of Economic Advisers. That question was posed to them and they more or less agreed they were.

Mr. RUTTENBERG. What I am trying to show here is that if we do agree, as I have with the Council of Economic Advisers and the President's budget message, of a 5 percent growth rate on a real basis, which means roughly $505 billion GNP for the year 1960, in 1959 dollars, and if we are really going to get the growth rate that we are now involved in getting in the first quarter in 1960, the implication of that figure is this chart which I have here.

By the time we get into the third and fourth quarter of 1960, our growth rates will be substantially reduced from the preceding quarters. The trend into 1960 appears to be a slowing down of the rate of growth as we get toward the end of the year, which in my judgment will lead us to anticipating some leveling off in 1961 that may well produce another recession.

We will probably have a leveling off and a stability in growth rate which, in effect, is stagnation as we move into the year 1961.

Now, if I might proceed to discussing a few specific points in terms of the outlook for 1960, if we take the budget estimate of the President in terms of what he based his revenue figures on of $510 billion gross national product, which on a real basis allowing for a 1 percent price change would be about $505 million, this is roughly a 5 percent increase in real gross national product in 1960 over 1959.

If we assume three-fifths to four-fifths of that 5 percent rise coming about as the result of resumed steel production and productivity, the rest of the growth rate, 1 to 2 percent of the 5 would then be attributed to the increase in the labor force or changes in the number of working hours, but basically to the labor force itself.

The CHAIRMAN. That has been increasing at the rate of 1.6 or 1.7 percent a year.

Mr. RUTTENBERG. Yes.

The CHAIRMAN. In population, but not necessarily in the labor force.

Mr. RUTTENBERG. In terms of the labor force the growth rate is about 1.2 percent, 800,000 per year during the 1955–59 period. The period 1960–65 will be about 1.4 percent and the labor force growth rate from 1965 to 1970 will be about 1¾ percent.

So if we assume that 1 to 2 percent of the growth rate in 1959 will be attributed to increases in employment, then we have a very interesting picture. A 1 percent increase in employment means 700,000 a year, based unpon a 70 million work force. A 2 percent increase in employment is 1,400,000.

Assume we take the outer range of the 1,400,000 increase in employment in the year 1960, and the labor force will grow by a million. This will be a net decrease in unemployment, assuming the most optimistic of the 5 percent figure, of 400,000 in 1960.

The labor force up 1 million, total employment on the basis of 2 percent up 1.4 million, a net decrease in unemployment of 400,000. This means as far as unemployment is concerned that it will be down roughly about 400,000 on this basis, and that means that we can estimate that—we know in 1959 unemployment averaged 3.8. If we get a decrease in unemployment of 400,000, it means that unemployment in 1960 will be roughly in the neighborhood of 3.4 million.

This is based upon a decrease to 4.9 to 5.4 percent of the labor force. So I am indicating that in terms of my chart here, which was also a chart from a majority report of this committee, indicating that there will be a leveling off at about 5 percent in 1960, which is indicated by the facts if we analyze the budget implications of the President's message itself.

He is content to see 1960 operate at a level of 4.9 to 5.4 percent of the labor force unemployed. This I say is a sad commentary on the achievements of a "full employment" economy.

Might I indicate another aspect of this problem very quickly that really shows the implication of the employment picture which I am terribly worried about in terms of the unemployment situation.

If we take the period right before the 1957–58 recession, industrial production was 154 on an index of the Federal Reserve Board. Nonfarm wage and salary employment was 52.5 million. In December 1959, industrial production has risen to 165 on an index from 1954. This is an 11-point rise, or roughly an 8-percent increase, while nonfarm wage and salary jobs in December 1959 were exactly the same as they were in July 1957, 52.5 million.

We have had an 8-percent increase in production with no increase in nonfarm wage and salary jobs.

The CHAIRMAN. What is the basis of comparison?

Mr. RUTTENBERG. July 1957, the month before recession.

The CHAIRMAN. Approximately 2½ years.

Mr. RUTTENBERG. That is right. I think if we would add to this the fact that manufacturing employment, and if we go further, production and maintenance, employment in manufacturing industries has declined; the productivity rate, if we apply it strictly to industrial production, is even greater than the implications of these figures.

These nonfarm figures take in total employment in trades and services in addition to manufacturing employment.

Representative CURTIS. May I ask on that, are you including the shift that has been going from blue-collar to white-collar workers in manufacturing?

Mr. RUTTENBERG. Yes. What I was implying was total nonfarm wage and salary employment is the same, July 1957–December 1959. But actually there has been an absolute decline in manufacturing employment, as such.

Representative CURTIS. In the blue-collar area?

Mr. RUTTENBERG. In manufacturing employment, excluding the white-collar worker.

Representative CURTIS. That is the point. The thing I am getting at is this: There has been a shift in the complexion of manufacturing employment from blue collar to what we call white collar. I do not know whether the absolute employment in manufacturing has declined.

Mr. RUTTENBERG. If we take production and maintenance workers of manufacturing, which does exclude any reference to white collar, this has been an absolute decline, even greater than the total decline in manufacturing.

Representative CURTIS. That is right.

Mr. RUTTENBERG. There has been a shift from blue collar to white collar just by the simple fact that total nonfarm wage and salary employment is the same when blue-collar employment of manufacturing has gone down.

The CHAIRMAN. But no net increase.

Mr. RUTTENBERG. But no net increase in total employment. Now, if I might talk a little to the problem of implications of the conditions of the national economy during the years 1960 and into 1961, may I say it is my firm conviction that the rate of growth in the national economy, as I indicate in my sixth chart that I referred to, will be at a declining pace.

Going into 1961, it appears to me we will be leveling off into a period of what might be called relative stagnation. I am fearful that we are going to be getting into a possible recession in 1961 unless something is done to reverse the current economic policies.

I want to talk a little bit about the economic policies that I think ought to be reversed. But before I do that I would like to cite a few figures, if I might. I will try to do this very quickly.

In automobile production in the first quarter of 1960, according to the New York Times report just a few days ago, the industry will be producing about 2¼ million vehicles. This is at an annual rate of 9 million a year. The best predictions that are made, the top prediction of any businessman in the automobile industry that I have been able to see, is 7 million sales in 1960, including at least a half million imports.

This means domestic sales of 6½ million cars. In the first quarter of this year we are producing at an annual rate of 9 million, which obviously means that there will have to be a decline in the level of automobile production as we move into the second and third quarters of this year. As a matter of fact, automobile schedules have already been announced at a lower level.

Representative CURTIS. You mentioned imports. What about exports?

Mr. RUTTENBERG. Exports in recent years, as you know, in automobiles, much to the regret of everybody, not only the industry but the workers involved in the industry, have fallen off substantially in the last 5 years.

Representative CURTIS. I know they have. What are your estimates. Is that going to pick up?

Mr. RUTTENBERG. My estimate is that it will not pick up in 1960 and will probably not pick up until we on the American market produce a much smaller car than the compact car that is now being put out in 1960.

It is really the size of the car and its efficiency abroad which has affected the level of American exports. This means that if domestic sales are going to be 6½ million and we are producing in the first quarter 9 million, there obviously has to be a dropping off of automobile production as we move into the latter part of the year.

Secondly, steel production: It is estimated that in the first half of this year we will produce at 93 percent of capacity, 70 million tons of steel. The best estimate that I have, even by Mr. Roger Blough, chairman of the board of United States Steel, or president, one or the other, is that it will produce 60 million tons of steel in the second half of 1960. This is at a rate of 80 percent of capacity.

This obviously means that automobile production will be tapering off in the second half, steel production will be tapering off in the second half. What we really will see in the first half of 1960 is inventory accumulation. We will see an inventory easing by midyear. This inventory easing by midyear is, in my humble judgment, the main reason why the annual growth rates in these last quarters of the year will be declining.

With that kind of a decline, what are the factors in the picture that are going to keep the economy moving forward at the rate that it is moving forward in the first and second quarters?

It has been estimated in the recent bulletin of the Chase Manhattan Bank that the inventory accumulation by the second quarter of 1960 will be $10 billion. The inventory accumulation in the fourth quarter of 1959 was zero.

The CHAIRMAN. You mean that is the addition?

Mr. RUTTENBERG. The net addition in inventory accumulation is roughly in the neighborhood of $10 billion. This will be a tremendous impetus to the economy. But you will get inventory easing as we move into the third and fourth quarters and the result of this inventory easing is, I think, a falling off in overtime of workers that are now working overtime in the auto industry; a dropping off of some employment in the steel as you drop from 93 percent of capacity to 80 percent of capacity; therefore, a leveling off of the rise in consumer disposable income that will take place during the first half of the year as the result of inventory accumulations.

The combination of this seems to me to lead one to the conclusion that we will have, as we move into the latter half of the year, a leveling off of inventories, a decline in auto and steel production, a decline in the increased rate of consumer disposable income, with a slowing down of the economy generally in the second half.

I am not predicting any recession or depression in 1960. I am not saying that for one bit. I am saying that the rate of growth as we move toward the end of the year will be declining. This kind of leveling off, unless bolstered, will level off in 1960 with really a strong potential of a possible unemployment situation.

Might I just point out that this story in the New York Times of about a week ago indicates that in the first quarter production will be 2¼ million automobiles, compared with 2.2 million, roughly about 150,000 fewer units produced in the first quarter of 1955.

In other words, we will be producing 150,000 more automobiles in the first quarter of 1960 than we did in the first quarter of 1955, which was the previous best quarter in the history. Then they add this statement:

But perhaps of even more significance, car makers are planning this huge output with 136,000 fewer hourly employees than in 1955.

Having indicated that I think consumer disposable income will be declining and that automobile production and steel production will be falling off in the second half, I think it is also true that residential construction during the entire year 1960 will be off slightly from 1959, with total construction about stable over the year because of some increases in industrial and some commercial.

So this will offset the decline in residential construction, so that construction will be neither a negative nor positive factor in 1960. Federal Government expenditures will be a slight positive factor if we take the budget estimates of the President, up about $1.4 billion in expenditure over 1960.

This will be a slightly positive side. Slightly on the positive side, State and local governments, their expenditures rising about three-quarters of a billion dollars, unless the continued tight money policy tempers the rise in the State and local expenditures because of their inability to finance much of their operation because of the high interest rates they have to pay, interest rates that might exceed their statutory limitations in many of the States and local communities.

Also on the positive side is a possibility of a slight increase in American exports. Exports seemed to begin to go up in the last couple of months of 1960 after a decline in early months. Steel exports increased slightly as we moved into January over what it was in December and certainly what it was during the period of the strike situation.

So we might have a net increase in exports of a slight amount of maybe a half to a billion dollars. That would have some slight effect on the economy.

The CHAIRMAN. Do you know what has been happening to imports in January as compared to the latter part of 1959?

Mr. RUTTENBERG. The only figure I have seen for imports in January was that they were up very slightly from December, but that exports appeared to be up a little more. But those are all preliminary estimates up to this point.

One of the strongest factors in 1960 will be plant and equipment expenditures. These are estimated to be up some 10 to 15 percent and with a steady quarter-to-quarter rise in the level of expenditures for plant and equipment. It is my own feeling personally that if the negative factors—and I think there are more negative than positive factors as we look to 1961—bear us out, unless economic policies are changed, we will be in for a decline in the rate of plant and equipment expenditures during 1961.

This will come about because if consumer expenditures drop off, then the incentive for increased plant and equipment expenditures will also drop.

I want to rush along because I want to finish in the time allotted me.

This leads to two problems. First, one conclusion that gives rise to two sets of problems that I want to talk about. The conclusion that I would come to is, as I have already indicated, there is a tapering off in the rate of growth that will take place after midyear and as we move into 1961 a leveling off, which leads me to believe that there is a great possibility—and I am joined in this by many conservative business and academic economists—that the leveling will occur in 1961 with the potentiality that this could be the beginning of another recession.

With that as a conclusion, I would say the responsibility of the Congress rests in two areas: One, Congress ought to be adopting specific programs that will help offset any recession once it gets underway. I hope that the recession will not get underway. I hope economic policies can be pursued that will avoid a recession, but I think we have to be prepared if the recession comes.

I think the two major factors that ought to be kept in mind that are strongly emphasized in the statement which Mr. Reuther has presented to the committee is (1) unemployment compensation which played a large role in preventing the downturn from getting worse in 1957–58. This could play a big role in any future recessions. For it to play a bigger and more important role, the level of unemployment benefits as well as their duration ought to be increased.

This is an important consideration. The Federal standards bill which is now up for consideration or has been before the Ways and Means Committee.

Second, I think we need a shelf of public works, not the kind of vital social needs such as schools and hospitals that we ought to be building anyway, but a shelf of public works of Government buildings, post offices, and so forth.

The CHAIRMAN. Mr. Ruttenberg, that touches upon a matter that I have wondered about a great deal. When my wife was a Member of Congress in 1945–46, I read the Congressional Record quite closely, and Congress was continually making appropriations to accumulate plans, engineering plans, for a shelf of public works. From time to time I have telephoned to try to find out where these plans were. I am told that there is a man in the Office of the President, I believe an Army colonel, who is supposed to be the custodian of those plans.

Do you know anything about them?

Mr. RUTTENBERG. We have been trying to find out a little bit about them and I am afraid I have come to about the same conclusion you have. They are very hard to find and there does not seem to be much push behind the idea, because it really takes Federal Government aid to State and local communities to start the planning of many types of projects, to acquire land, to begin to develop and build the blueprints that are so essential.

The CHAIRMAN. These appropriations were for the specific drawing of the blueprints, not for the acquisition of land. Were the blueprints drawn? Do they exist? Does anyone know what the projects are? Does anyone know whether they have been kept up to date? Has all this money gone down the drain? What has happened?

Mr. RUTTENBERG. If there is a shelf and if they are prepared to move, I have not been able to find where it is in Government.

Representative CURTIS. Have you really tried, Mr. Ruttenberg?

Mr. RUTTENBERG. Yes.

Representative CURTIS. Anyone who examines the public works bill finds all of these projects that have been put aside because of the doctrine of "no new starts" I think would find no difficulty in finding a considerable shelf and just interrogate each individual Congressman about the projects in his own district. I am afraid we have a shelf that is so big that it is pretty hard to absorb. I could list a number in my own district.

The CHAIRMAN. I wonder if the Congressman from Missouri would agree that this would be a good subject for the Joint Economic Committee to pursue to find out where these plans are and what they are.

Representative CURTIS. I think it would be excellent for this reason if no other, because we could get some of the dogs out. There are a lot of good projects. Actually, the increase of the amount spent on public works has been increasing. The amount of backlog is—I have forgotten what the figure is—many billions.

All I am saying to the gentleman from Illinois is that there is a shelf and just because Mr. Ruttenberg and he have not seen it, it is there. How well it is analyzed, that is a different matter.

The CHAIRMAN. I would like to see a classification that is not merely geographical, but by type of purpose.

Representative CURTIS. Take post office buildings which were mentioned. I happen to know a little bit about the projected plans on that. They do have a very comprehensive program for building new post offices. I know the scheduling in my district. We are biting away at it and making some progress.

The CHAIRMAN. I wonder if it would be satisfactory if we could have a letter drawn up by the staff to a proper official asking for a report on this subject.

Representative CURTIS. I would join in it. I think maybe it would be well to write it to Congressman Cannon of the Appropriations Committee. I suspect he has as good a list as any on the shelf because he provides the gateway for these projects.

The CHAIRMAN. I think we should have a classification by purpose and degree of completion.

Mr. RUTTENBERG. I would like to emphasize the latter point the chairman made, the degree of the completion of the plans. I have no doubt that the no-new-start doctrine has gotten into the picture.

At what stage are the blueprints, at what stage is the acquisition of land? If something happened and they abolished the no-new-starts policy, could they move on starts?

Representative CURTIS. As I understand, under the no-new-start doctrine, they permit a go-ahead with engineering designs. I have a project in my own district where I have been trying to get $100,000 to update the study plans, but I cannot get that through.

Representative PATMAN. Mr. Chairman, may I suggest that a few years ago when I was chairman of the committee I asked for the same information, and we received it up to date. I think it was General Bragdon that furnished it to us. I suggest that you communicate with him and ask him to bring us up to date.

The CHAIRMAN. Do we have a report on this?

Mr. LEHMAN. This came up in connection with the committee hearings 2 years ago.

The CHAIRMAN. I would ask the staff to analyze that report and if further information is desirable, prepare a letter requesting it.

Representative CURTIS. I think it would be excellent. The Bureau of the Budget can give us some data on it, too.

Representative KILBURN. Mr. Chairman, don't you think it would be a good idea to have the pet projects of each member of this committee put at the top?

The CHAIRMAN. No, I do not. I know my good friend is interested in the development of the Adirondacks, and I supported him on the St. Lawrence.

Representative PATMAN. I did, too.

(The following was subsequently received for the record:)

FEBRUARY 20, 1960.

Maj. Gen. JOHN S. BRAGDON,
Special Assistant to the President for Public Works Planning,
The White House,
Washington, D.C.

DEAR GENERAL BRAGDON: The Joint Economic Committee, at its recent hearings on the President's Economic Report, discussed the question of the existence and nature of a shelf of public works. As an outgrowth of this discussion, it was requested that I ask you for a report on the current status of Federal, State, and local public works plans and programs and your evaluation of the speed with which such programs could be undertaken.

You will recall that a similar request was made by the then chairman of the committee, Congressman Wright Patman, on February 11, 1958. You indicated at that time in your reply to Mr. Patman that you were carrying out certain staff studies in regard to the plans for public works. Have any of these studies been completed in such form that they can be submitted to the committee? If so, it would be most helpful to have copies of these materials.

It would be greatly appreciated if you could reply to this request during the coming week in order that we might include your reply and accompanying materials in the printed copy of the hearings.

Sincerely yours,

JOHN W. LEHMAN,
Acting Executive Director.

THE WHITE HOUSE,
PUBLIC WORKS PLANNING,
Washington, February 24, 1960.

Mr. JOHN W. LEHMAN,
Acting Executive Director,
Joint Economic Committee,
Congress of the United States,
Washington, D.C.

DEAR MR. LEHMAN: Your letter of February 20, 1960, requested a report on the current status of Federal, State, and local public works plans and programs, and my evaluation of the speed with which such programs could be undertaken. Other than the information which is already available to your committee, such as that published in the Bureau of the Budget's annual public works analysis, HHFA reports, and Department of Commerce bulletins, I know of no printed reports containing current information of this nature.

At the time of my correspondence with the Joint Economic Committee 2 years ago, special staff studies were underway to determine the status of Federal public works projects in several of the executive departments. Shortly thereafter these special studies were completed and submitted to the President. They were of an informal nature and for a specific purpose. I am sure you can appreciate that as a member of the President's staff it would be improper for me to disclose information on special studies undertaken for his personal use.

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In regard to non-Federal programs, developments during the past year will advance public works planning at the State and local level and will provide additional and more current data on the status of such projects. The housing Act of 1959, Public Law 86–372, by amending the Housing Act of 1954, provides (in sec. 701) for grants-in-aid for comprehensive planning to States, regions, metropolitan areas, cities, counties, and small communities. It also authorizes (in sec. 702) the use of $50,000 annually from a revolving fund for surveys of the status and current volume of State and local public works planning and of the requirements for State and local public works. The Community Facilities Administration is preparing to undertake the first survey authorized by this legislation. The study is expected to be completed by the end of this year.

Doubtlessly, you are also familiar with the Community Facilities Administration's program of advances for public works planning. Its January 31, 1960, report indicates that advances from its revolving fund of $29.3 million have resulted in plans for $1.8 billion of public works construction. This program and those authorized by the Housing Act of 1959 are of substantial assistance in strengthening the planning of State and local public works.

Sincerely,

J. S. BRAGDON,
Special Assistant for Public Works Planning.

The CHAIRMAN. We have taken up a lot of your time, Mr. Ruttenberg. I wonder if you could finish in 5 minutes?

Mr. RUTTENBERG. In 5 minutes time let me outline that if we counteract the recession through a shelf of public works and unemployment compensation, I would hope we can reverse economic policy so we do not have to go through such a recession and resort to unemployment compensation payments or public works construction.

I think in order to reverse the basic economic trends that are pursuing the economy at the moment, it would take, I would suggest, three specific, broad, general areas as far as the Congress of the United States is concerned.

First and foremost in my mind is the tight money policy. I think an easing up and a reversal of our existing tight money policy would be extremely advantageous to the economy as a whole. I think our economy has been squeezed substantially by a declining level of money supply as a percent of gross national product.

I think if we look at the 1953 situation, the money supply was about 34 percent of the gross national product at the time. It has since dropped, until now in 1959 the level of money supply as a percent of gross national product is 29 percent.

This relationship is approaching the relationship of money supply to GNP that existed in the years immediately preceding the great depression of 1929. I do not say that there are not other considerations that are entering into the picture today that did not exist in 1929, but I am saying that the squeezing of the money has held down the rate of economic growth and in my judgment has been partly responsible for the fact that the gross national product in the last 7 years, per capitawise, has risen by only six-tenths of one percent a year.

I think we need an easing up of money policy. I would endorse almost completely, with one variation, the position taken by the majority members of this committee, and in a speech by Senator Douglas on the floor of the Senate on the question of tight money.

I would only emphasize one point which I do not think was emphasized strongly enough in that report, namely, that we ought not to bridge the 4¼ percent ceiling even if they do all the other things that should be done, because if they did all the other things as out-

lined in the report, and Senator Douglas in his speech, then the problem of breaking through the ceiling would automatically eliminate itself and it would not be an issue.

The CHAIRMAN. I did make the comment that I thought it would eliminate itself.

Mr. RUTTENBERG. It would eliminate the issue. It is just a question of whether one says we ought to break the ceiling of 4¼ if we do these things, or saying it the other way around, if we do these things, it will not be necessary. It will be an academic issue as to whether we have to break the ceiling. That is the only point I am making.

It is a kind of reversal of how you say it. Secondly, I would say that one of the other big problems is the budget implications of this Government. I think that placing the balanced budget notion ahead of our need for schools and hospitals and other vital, necessary, urban renewal and housing programs is a sad commentary.

Our total population is bursting at the seams. Our fulfilling and meeting the needs of hospitals and schools and houses in our urban centers and cities and rural slums and so forth, have been so little taken care of that we must be continually expending Federal money in these areas.

I think by spending Federal money in these areas, we will continue a growth rate in the economy which would enable the Government to grow at the 5 percent rate which I indicated on my first chart which would permit an increase in Federal revenues to offset the cost of some of these programs that I am talking about.

Certainly I would include in these programs military, national defense, space, foreign economic aid, as well as being important things which we as a country and as a Government ought to be actively pursuing at the most rapid rate. We ought not to let budget considerations intervene in that.

I would add as a third point to fit into this picture, we ought to have tax revision, not tax reduction, because I think as we look to the future we are not going to be able to reduce taxes by very much. I think the great need will be for increasing budget expenditures to meet the social welfare needs of this economy.

I would urge strongly we get tax revisions similar to some of the proposals that have been made in terms of dividend withholding, elimination of the dividend credit, some alteration in the depreciation of capital gains taxes.

If we did this, we could raise more revenue to meet the budget needs of our Government and we could give necessary relief to the middle and lower income people that deserve to have the burden of taxes taken off their back and shifted on a more equitable basis up the line.

I may conclude that in addition to these items, we ought to be moving regardless of economic circumstances to do something about depressed areas, we ought to be doing something about revising our Social Security Act, mainly in terms of medical care and sick help for the retired workers as proposed in the Forand bill that is up for consideration in the Ways and Means Committee.

We ought to continually keep under study the price situation which this committee has done well with and Senator Kefauver's committee has done well with. We ought to create a Commission on Tech-

nological Change so we can follow that problem more clearly every year.

As I indicated up to now, this concept of being able to produce more automobiles in the first quarter of 1960 than we did in 1955 with 136,000 fewer workers in the automobile industry, this proposal for a Commission on Technological Change is one of the points contained in Mr. Reuther's overall statement.

The CHAIRMAN. May I say that this committee has a Subcommittee on Automation and Technological Change headed by Congressman Patman, and the plans for the coming year call for a continuation and intensification of the efforts of that subcommittee.

Mr. RUTTENBERG. I think, Mr. Chairman, with remarks, I have gone over my time and I will conclude.

Thank you very much.

The CHAIRMAN. The chairman has to go to the floor of the Senate to join in the tributes to the late Senator Langer. I am going to ask Mr. Patman to begin the questioning and preside in my absence.

Representative PATMAN (presiding). Thank you, sir.

Mr. Ruttenberg, you are on the Committee for Economic Development's study of the monetary system, are you not?

Mr. RUTTENBERG. The Commission on Money and Credit; yes, I am.

Representative PATMAN. I want to invite your attention to certain points I hope you do not overlook. No. 1, there is an effort being made to show that high interest is necessary in order to induce savings. I think that is a fallacy. I think statistics will show that it is a fallacy.

Next, that under the so-called pegging process of the Federal Reserve before the so-called accord on March 4, 1951, the Federal Reserve had to buy enormous quantities of Government securities in order to prevent a ruinous inflation. That also is untrue.

I wish you would consider as a member of that committee that there is one way to solve our money problems for the present, and the policy will be helpful in the future, and that is to retire a certain amount of the Federal securities that are owned by the Open Market Committee.

May I invite your attention further to the fact that yesterday we had distinguished economists like Mr. Musgrave from Johns Hopkins, and Mr. Smith from Michigan. They agree that they looked upon those bonds as having in effect been paid when the Federal Reserve took Uncle Sam's money and bought these Government securities.

They went so far as to say that they should not even be carried as a part of the national debt. There is no doubt but what these bonds have been paid in honest money and honest dollars by the U.S. Government and they should not be paid twice or three times or four times, as they can be under the present system.

So I hope you look into that carefully. I will make my questioning as brief as I can. There are certain things that I think are very important and those I have mentioned I believe are very important.

Day before yesterday, Chairman Martin appeared before the committee and made some glowing statements about the tremendous amount of savings that were induced in 1959.

The New York Times of yesterday reported, and I quote—this is just a sample——

Representative CURTIS. Now just a minute. I am going to insist that the full quotation go in and not just an excerpt.

Representative PATMAN. That is perfectly all right.

Representative CURTIS. If you have the article, put it in.

Representative PATMAN. This is it.

Representative CURTIS. I do not know, after yesterday. If the gentleman wants to read the full article——

Representative PATMAN. I will assure you that this is all the New York Times said about this one thing.

Representative CURTIS. You assured me about the other. I would like to request the full article go in. You can quote the point you want, but let us have the full article.

Representative PATMAN. I will read it and if there is anything different we will put the whole article in.

Representative CURTIS. I request the whole article go in and the gentleman can read the part he wants.

Representative PATMAN. I want to refer to this and I will put the whole article in.

> Mr. Martin also suggested to the committee that constant complaints about tight money were amiss in the light of last year's record. He said that total credit and debt expanded in 1959 by $60 billion, one-third more than the previous peacetime record.
>
> He called this figure "amazing" and "sensational." The money to supply this extra large borrowing demand came, he said, not from newly created money in the form of bank credit, but from a huge volume of funds provided by individuals and corporations attracted by high interest rates.
>
> The year's performance, he said, was "an amazing demonstration" of how higher returns for the investor attract savings.

That is a direct quote from the New York Times. If there is anything else that relates to that, I will put the whole statement in. Actually, if you go back and read Mr. Martin's statement carefully about three times, I think you will find that he did not actually say that higher interest returns brought about the savings which he considered amazing and sensational, but he said many things in many ways which would inevitably be interpreted the way the New York Times reporter interpreted it.

I have noticed that Mr. Martin has a way of almost saying what the newspapers want to hear, and coming so close to saying it that the reporters go ahead and report it the way they wanted to hear it.

Representative CURTIS. I object to this technique. Mr. Martin is not here. This is casting aspersions on him. The gentleman is certainly entitled to say all these things, but I want to appeal to his sense of fairness. This is his interpretation and I just think it is not proper to proceed in that fashion.

Representative PATMAN. You must wait, Mr. Curtis, until I finish. I am leading up to the figures that I want to produce in the record.

Representative CURTIS. Yes; that part is all right. Certainly the gentleman is entitled to say what he wants to. What I am saying is that you are attacking Mr. Martin's integrity in the language you have just read. I am just appealing to you to let his statements speak for themselves.

Representative PATMAN. I do not know whether it is an attack on his integrity. I am stating that the New York Times carried a distorted story about his testimony and I am really defending Mr. Martin in a way. I am saying that he did not actually say that.

Representative CURTIS. I think he would prefer not to have this kind of defense.

Representative PATMAN. What are the facts about these "amazing" and "sensational" savings last year? According to the Department of Commerce figures, individuals in this country saved the lowest percentage of their incomes last year—the year 1959—of any year except one in the past 9 years.

I am basing this statement on the seasonally adjusted income and savings figures for the first three-quarters of the year. The fourth quarter figures are not available. In fact, the Federal Reserve has just published the third quarter figures in its bulletin for January, which came out on January 30.

On the basis of the Department of Commerce figures, individuals saved only 7 percent of their disposable personal income last year. Disposable personal income is, of course, personal income less taxes. In other words, this is the income which individuals can control, to spend or to save as they choose. In only one other year has there been a lower percentage of saving. This was in 1955. The figures, beginning with 1951, are as follows:

Personal savings as percentage of disposable personal income

Year	Percent
1951	7.8
1952	7.9
1953	7.8
1954	7.4
1955	6.4
1956	7.9
1957	7.5
1958	7.4
1959	7.0

Now let me refine this statement. Mr. Martin was not basing his statement on the Department of Commerce figures but on the Federal Reserve Board's "Flow of Funds and Savings" reports. This report is also available only for the first three quarters of last year, and unless something truly "amazing" and "sensational" happened in the last quarter of the year to make the yearly totals much unlike the first 9 months of the year, I suggest we will find nothing to support Mr. Martin's statement.

Now, in considering consumer savings as the Federal Reserve reports them, we have to remember that they differ from the Commerce figures in several particulars.

Representative KILBURN. Mr. Chairman, may I make a parliamentary inquiry?

Representative PATMAN. Certainly.

Representative KILBURN. Very respectfully, do we have any other witnesses?

Representative PATMAN. Yes.

Representative KILBURN. Are we going to be permitted to question the witness or listen to a speech by the chairman.

Representative PATMAN. Without objection, I will put it in the record.

Representative KILBURN. It is all right with me either way because I have heard this so many times.

Representative CURTIS. Is that a question to the witness that you are putting in the record?

Representative PATMAN. It is something pertinent to it.

Representative CURTIS. We are supposed to be questioning the witness.

Representative PATMAN. The main difference is that the Federal Reserve counts all consumer purchases of consumer durable goods—automobiles, television sets, washing machines, and so on—as savings, even though consumers go into debt to make these purchases.

Likewise, the Federal Reserve Board counts consumer purchases of houses as savings even though the consumers go into debt. So it is obvious that we cannot count the increase in consumer purchases of automobiles and so on and housing as something stimulated by high interest.

On the contrary, the increased purchases of these things were made in spite of the high interest consumers have to pay to finance these things.

Coming down, then, to the question of consumers' net financial investments, in the first three quarters of last year the Federal Reserve reports show that this amounted to $9.3 billion.

In other words, if we add up the consumers' acquisition of assets in the form of bank deposits, savings bonds, savings through life insurance, savings through pension funds, and their purchases of stocks, marketable securities, and mortgages, we find that all these asset acquisitions which we could call savings exceeded their increased debt in mortgages and consumer credit by only $9.3 billion.

By comparison, in the first three quarters of 1958, a recession year, consumers made net financial investments amounting to $9.7 billion. So, in absolute terms, consumer savings in the first three quarters of 1959 were actually less than in the first three quarters of the recession year, 1958.

So we can hardly say that the high interest rates last year caused consumers actually to save a larger part of their incomes rather than spending their incomes and going further into debt in home mortgages and in consumer credit.

Coming now to the corporations which Mr. Martin's statement suggests contributed to a great increase in savings as a result of high interest, this is the background:

Corporate profits went up greatly in 1959 as compared to the recession year of 1958. Further, after paying taxes and paying dividends, their retained earnings were greater.

Also, they increased their capital expenditures for plant and equipment and increased their inventories. But here again it can hardly be said that the high interest rates encouraged the corporations to make investments in expanding plant and equipment.

The Federal Reserve has been going on the opposite theory, that it raises interest rates to discourage expansion of plant and equipment and expansion of inventories. Yet these expenditures are counted as savings in the Federal Reserve's report.

Let's look then at what the nonfinancial corporations actually did save. This amount would be their net acquisition of financial assets—their increased holdings of bank deposits, equity and debt instruments, and so on, minus their increases in liabilities.

What we find here is that in the first three quarters of the recession year 1958, the nonfinancial corporations went into debt on a net basis by $1.6 billion. In the first three quarters of 1959 they went into

debt on a net basis by $1 billion. So obviously we cannot say that high interest rates tended to encourage corporate savings.

Actually, I think you will find Mr. Martin did not say that. What he said was that the high interest rate was the price the country paid for the amount of savings which were made under the circumstances, and the circumstances were that in 1959 he reduced the supply of money relative to the amount of goods and services being produced so the country paid a higher price for the use of that money to carry out each of its production and distribution processes.

I will ask the question now. Don't you agree that the savings last year were lower than the savings in any year in the last 9 years except 1955?

Mr. RUTTENBERG. I think the figures of economic indicators which are prepared jointly by this committee and the Economic Advisers, on page 5 of the January 1960 issue, clearly indicate that the figures Mr. Patman read are the figures from this table.

Representative PATMAN. There is one other question and then I will yield to Mr. Curtis.

The question is about the propaganda over the country to the effect that this pegging of Government bonds was a terrible thing, which kept the interest rate down to 2½ percent and kept bonds from going below par.

The Secretary of the Treasury made a typical statement about that which I wish to read. It is not very long. It is in the U.S. News & World Report. The question was:

> We read that some people would like to force the Federal Reserve System to peg the prices of Government securities. Wouldn't this help bring interest rates down?

I want to read his answer:

> It might temporarily, but the inflationary dangers would be great. We tried this system during World War II and for about 6 years after the war. It really led to disaster. It became so inflationary after the outbreak of fighting in Korea that the Treasury and the Federal Reserve agreed that the program had to be stopped; that its costs to the American citizens were simply too high. This would be one of the worst things we could do. It could turn the Federal Reserve System into a very high-powered engine of inflation.

Representative CURTIS. I would like to make the request that the full article from which the gentleman has read this one small quotation be made a part of the record at this time.

Representative PATMAN. Without objection, it is so ordered.

(The article to be furnished follows:)

[From U.S. News & World Report, Aug. 31, 1959]

INTERVIEW WITH SECRETARY OF THE TREASURY ROBERT B. ANDERSON, HOW MUCH WILL YOUR DOLLAR BUY?

All over the country, people are worrying about inflation. You hear warnings that the dollar's value is going to shrink still more.

Treasury Secretary Robert B. Anderson, in this exclusive interview, insists that inflation can be halted—and gives his formula for doing it.

In this connection, he explains why he considers it important to remove the legal ceiling on interest rates paid on Government bonds. A bill to lift this ceiling was rejected by the House Ways and Means Committee on August 18. The President was expected to appeal to the country for a reversal of that action.

Q. In a general way, Secretary Anderson, what is going to be the future of the dollar? American people, in making their plans, want to know. What do you think the dollar is going to buy 2 years from now? Is it bound to buy less?

A. If we manage our affairs properly, there is no reason why we shouldn't have reasonable stability in the purchasing power of the dollar.

Now, this means that, in times of high levels of business activity, the Government has to live within its means. It means that, during these periods, you should try not only to barely live within your means, but you should provide something for debt retirement.

Q. Do you relate the future of the dollar entirely to the way the Government handles its finances?

A. No. The actions of millions of individuals and business concerns are, of course, very important. In a democracy, a free economy, all of us must act responsibly.

But it seems to me that, if Government itself doesn't act responsibly in handling its financial affairs, then we can't expect that individuals and private institutions will exercise the degree of responsibility that is desirable and necessary.

INTEREST CEILING ADDS TO "DANGER OF INFLATION"

During periods of high levels of business activity, such as the present, we should have reasonable restraints on the rate at which credit increases, for we know that too rapid an expansion in credit causes inflation. And we should manage our $290 billion national debt in a way that avoids adding impetus to a booming economy, so as to create such a rapid rate of growth that it can't sustain itself.

This means the debt should be managed in a noninflationary way. Unfortunately, the 1918 interest-rate law prohibits the Treasury from selling anything but short-term securities. These securities are more like money than long-term securities. The more of them we issue, the more danger there is of inflation.

This is an important reason why the 4¼ percent interest rate ceiling should be removed by repealing that 1918 statute. If it's removed, we'll have a much better chance of avoiding inflation and protecting the value of the savings of millions of Americans.

Q. What has brought the purchasing power of the dollar down in these last years? It was brought down about 52 cents in the last two decades.

A. I do not think it is possible to single out any one thing and say that this is the cause of the depreciation of the currency. For one thing, though, you must always have a sound relationship between the rate at which wages increase and productivity increases.

Q. Why does that affect it?

A. If your wages increase much more rapidly than productivity, then your cost, or price, of articles tends to rise. If, on the other hand, you have a reasonably sound relationship between the two, then this helps keep the purchasing power of the dollar stable.

Another matter of importance was pointed out by Marriner Eccles [former Chairman of the Federal Reserve Board] in a statement on August 2 of this year, and I quote him:

"A large part of the postwar price inflation was a result of the Federal Reserve's purchasing billions of dollars of Government securities at fixed prices in order to prevent an increase in interest rates."

Q. Do you mean the Government stepped in and bought bonds in order to get enough money for the Government to run on?

A. Not exactly. What we did following the war was to peg the price of long-term securities.

Q. What do you mean by "peg" it—fix it?

A. Any time the price went below the peg, or the fixed price, the Federal Reserve would buy securities. This artificially kept the interest rate from rising.

Q. Then, did Federal Reserve manipulate the market in order to keep the price of money down?

A. Well, they pegged the interest rate partially because they did not want the interest rate on Government securities to rise—because, if it did rise, the cost of carrying the public debt was greater. Now, the penalty we paid for it was putting additional money into the stream of activities, without specific relation to the demands of the economy, but in order to keep the price of the Government securities level.

Mr. Eccles, who was Chairman of the Federal Reserve during this period, says this:

"The Treasury and the White House, over the strong protest of the Federal Reserve, required this action to be taken. In doing this, an excess amount of bank reserves was created which brought about an inflationary expansion of commercial bank credit and of the money supply. The present administration and the Federal Reserve are trying to avoid making this mistake by curbing the growth of bank credit, and allowing the interest rates to rise."

The simple way to put it is that what we are trying to do is to compete in the free market for the money that is required by the United States—just like all other borrowers compete for it—rather than to fix a price at which the Government securities are going to sell, and maintaining that price by highly inflationary purchases by the central banking system.

Q. How does the tax situation relate to the future purchasing power of the dollar? If the Government has to pay more for the things it buys, does it have to increase taxes, or does it get increased receipts to take care of it?

A. The extent to which one pays more for the same commodity because of inflation, the more the cost of the Government rises. Tax receipts will go up, too, on the basis of existing rates, because business profits will rise. Also, more people will go into higher income tax brackets as their dollar incomes go up.

Now, as to whether or not you can at the same time increase tax rates depends to a great extent upon whether the political climate and other factors are such that people are tolerant of adding to their tax burden. But certainly it is not a sound principle to allow prices to rise through inflationary pressures simply in the hope that they can be offset by increased revenues to the Government.

"BE THANKFUL WE HAVE A PERIOD OF RELATIVE STABILITY"

How inflation builds up

Q. Why won't this price situation take care of itself by people refusing to buy when prices get too high? Why do we have to take any measure to stop inflation?

A. The situation would indeed take care of itself in this way if we were careful not to expand the money supply too much.

One big reason is that if we pump a lot of money into the economy, as we did during the war, a great deal of pressure builds up on prices. This is why we need to restrain credit during a boom, and why we have to be careful to manage the debt in a way that doesn't add too much to the money supply. If we are not careful in this way, there is no automatic correction—other than a severe recession—to bring prices down. More and more money just chases prices higher and higher.

Q. Since there is a natural shrinkage of production when prices get high, why wouldn't that restrain the price rises?

A. If you're going to have a sustainable rate of growth in the country, it seems to me that you have to be assured of a sufficient volume of sales out of which a new plant capacity can be met, the fruits of inventions turned into realities—into productive machinery—all this sort of thing.

Now, if you have a widely fluctuating currency and people are not inclined to save, they are not inclined to provide funds out of which expansion can be made—you get a completely distorted picture of what is the real growth of the country.

Q. The public is getting the impression that there isn't anything too much wrong with inflation. They read in the papers that corporations have been making tremendous profits and that unemployment is vanishing, that this country is prosperous and personal incomes are up. The average man is asking, "What is this inflation thing doing that's wrong?"

A. Looking back over the past 17 or 18 months, we have had about as relatively a stable period of prices as we have had in some time. The all-commodity price index has been about level. There has been practically no change in the value of the dollar. Food prices have tended to be a little bit lower, some other prices have risen. There has been practically no change in the cost-of-living index. Therefore, there is a tendency for people to say, "Where is the inflation that you are concerned with?"

We are not concerned about the fact that we are remedying a situation in the past, but rather to be sure that we do not in the future allow inflation to

become a problem. If a person is reasonably and prudent, he does not wait until he has a difficulty and then take measures to get out of it. You don't lock the barn after the horse is stolen. You do it first.

The reasonable and prudent man should be thankful we have a period of relative stability. We will try to conduct our country's affairs so that we will maintain this price stability and at the same time a period of growth at a rate which can be maintained.

Q. Would you say that the cashing in by the public of more saving bonds than they are buying is a danger signal?

A. It is certainly a signal in the wrong direction. We have to be aware of the fact that as many as 40 million Americans own $42.5 billion worth of E- and H-bonds. They, I believe, regard the United States as something of a trustee, and rightfully so. They expect of their trustee that they will be treated fairly in the earning of their money as compared to what could be earned elsewhere. And they believe that we should be able to protect their investment from declining in value in terms of what their money will buy.

As long as they are confident that we are going to do these two things, they will continue to own our securities. If they should decide that they are not being treated fairly or that we have given up or are unable to maintain the purchasing power of the dollar—to prevent inflation—then they would take actions to protect themselves.

This is why our pending legislation on interest rates is so important to the American citizen.

In the first place, the legislation would remove the ceiling rate on savings bonds and we would, as we have announced, raise the rates to maturity on new bonds from 3.25 to 3.75 percent, effective as of last June 1. This would provide a fair, competitive return to savings bond holders, and it would apply to all bonds purchased since June 1, 1959. Also, we would increase for the future the return on bonds bought before June 1 by one-half of a percentage point, so nobody who owns a bond has any reason to turn it in for a new one.

In the second place, we believe that we could do a more effective job in fighting inflation if we were permitted to sell some new marketable securities at long term instead of short term. Sole reliance on short-term financing, as I noted earlier, adds to inflationary dangers. But, by selling some long-term bonds, we could help protect the purchasing power of the dollar. This would guard against a decline in the value of the dollars people have put into savings bonds and make them more willing to buy and hold them.

Effects of borrowing

Q. It is often said that borrowing from the banks raises some of the same problems that issuing an excessive amount of new paper money does. Just what is meant by that?

A. There is a difference, of course, between the two under present conditions. But if we rely excessively on bank borrowing, we will soon find ourselves in much the same shape as if we had printed too much paper money.

Now, when the Government sells securities—unless it sells them to the banks—they are paid for with money which has already been saved. No new money is added to the amount people have in their pockets or in their checkbooks. The Government hasn't done anything to push prices up when it keeps away from bank borrowing. But when it has to fall back too much on the banks, new deposits are created—with only a small reserve backing them up—and that's almost as bad as creating too many new dollar bills.

Q. Do you mean that banks, in buying Government securities, do not lend out their customers' deposits? That they create the money they use to buy the securities?

A. That is correct. Banks are different from other lending institutions. When a savings and loan association, an insurance company, or a credit union makes a loan, it lends the very dollars that its customers have previously paid in. But when a bank makes a loan, it simply adds to the borrower's deposit account in the bank by the amount of the loan. This money is not taken from anyone else's deposit; it was not previously paid in to the bank by anyone. It's new money, created by the bank for the use of the borrower.

It is hard to avoid bank borrowing at any time, but it's doubly hard when the only securities the Treasury can offer are short-term securities which the banks like best.

Q. What has this got to do with short-term debt?

A. Banks like to buy short-term bonds, not long ones. They have to be ready to pay at least a part of the millions of checks depositors write every day. They find short-term bonds practically riskless, because they know they can get their money back 100 cents on the dollar very soon. They might get in trouble if they tried to keep too many long-term bonds and everybody wanted to sell them at once.

Q. You refer to banks losing money when interest rates go up and bond prices go down. It is true, isn't it, that banks gain a great deal from rising interest rates?

A. No. That is a common misconception. It is true that banks earn higher interest rates on their loans under such conditions; that's to be expected when money is scarce relative to the demand for it. But what is often overlooked is that the values of their investments in Government bonds and other securities go down at the same time. If they want to make new loans at the higher interest rates, they are probably forced to sell some of their Government securities at a loss.

Over the past 4 years, which includes about 3 years of prosperity and 1 year of recession, commercial banks have lost more than they have gained from their sales of securities. Also, people often overlook the fact that higher interest rates are costly to banks. As interest rates have risen in the past few years, competition has forced banks to pay higher interest rates on time and savings deposits. It is interesting to note that, since 1946, the amount of interest banks received from Government securities has increased about $200 million, but their total interest paid out on customers' time and saving deposits has risen by almost $1 billion.

"THE GREATER THE FEAR OF INFLATION," THE HIGHER THE INTEREST

Why money costs rise

Q. Can the fear of inflation really make the price of money go up?

A. Yes. If people who have money to lend begin to worry that the dollars they are loaning out now won't be worth as much when they get them back, then they are going to ask for a higher price. They'd like a little insurance against the likelihood of an inflationary price rise, and the only way they can get it is to charge more interest. Part of the additional interest is really an insurance premium. If your community has a good fire department, your fire insurance isn't too expensive; but if it hasn't, you'll find the cost of your fire insurance going up.

The lenders are in the same boat on inflation protection as the fire-insurance companies are to fire protection. Both have to cover their risks or they might have serious losses. The greater the fear of inflation, then, the higher is the charge for loaning money.

Q. Mr. Secretary, could it not be the expectation of higher rates of interest generally—as much as the fear of inflation—that is causing the cashing in of the savings bonds and also the weakness in marketable bonds? It seems to be widely assumed that there exists a genuine and very deep fear of inflation that is causing this weakness in the bond markets.

A. Certainly both factors are important. But the fear of inflation is a substantial reason.

Q. Isn't there also this factor of demand for capital—an expectation that we will be operating at a high rate, will need a lot of capital and hence we will have to have high interest rates?

A. In any period of high levels of business activities there is more demand for money. This is a characteristic of such a period. As the demand for money increases in a free market, the price of the money increases—even without inflation. The saver is like anybody else who has something to sell or to rent: If he believes that the price of his money is going up, he wants to take advantage of the highest price he can achieve.

When funds were cheaper

Q. Why have interest rates risen so much in the past year?

A. We've been operating in a free credit market ever since the Treasury-Federal Reserve accord of 1951. But during the period 1951–59 there have been several ups and downs in the prices at which money is available.

If you look back only a little more than a year ago, the Government was borrowing money very cheaply—under 1 percent for our very short-term bills. Most of the people who were competing in the market for money were also

borrowing it very cheaply. There was no "money magic" involved in this; it was due to the fact that we were in a recession. Fewer people wanted to borrow and more people wanted to lend. So the price of money was cheaper.

Then, in June of last year, people began to realize that a turn had come. Also, the first realization came that the Government had a very large deficit ahead of it. This deficit was going to have to be financed during a period of rising levels of economic activity when other people would be demanding money on the market. All of these things combined to cause interest rates to shift very rapidly.

Q. Has the 4¼ percent ceiling ever caused trouble before?

A. In 1919 Mr. Carter Glass, who was then Secretary of the Treasury, asked the Congress to remove the ceilings on interest rates that would be put on all new issues of Government securities up to 10 years. In response to his request, Congress took off the interest ceiling on securities up to 5 years, but it did not take off the ceiling beyond 5 years—which is the precise problem we're dealing with today.

When the ceiling was not taken off bonds beyond 5 years, the Treasury was forced to go into the market 28 times in 1920 and 1921 to borrow money for the Government. We paid 5 percent or more for all of this short-term money. This was costly to the Government just as it's costly now to crowd all of our financing into the short-term area of the market.

Q. But why didn't we continue to have high rates during the prosperity of the 1920?

A. In 1920 we began a long period in which we began a retirement of the national debt, and between 1920 and 1929 we retired a third of the national debt in this country. At the same time we had a rising level of business activity. Interest rates did not rise because the Government, instead of being a borrower of money and therefore a user of money out of the market, supplied money by paying off debt.

If we were in a period today in which we were retiring a very substantial part of the debt, rather than being a borrower of funds, we would be in a completely different situation.

Q. How about since then?

A. In 1929 came the stock-market crash and the depression which followed in the 1930's. Naturally, interest rates were low in the depression. Confidence in the future was shaken and very few people wanted to borrow.

In the early 1940's came World War II, and during the war we had direct controls on prices—including the price of money. During and after the war we had a peg on the price of long-term Government securities. Then came the Korean conflict. After that and after the Treasury-Federal Reserve accord of 1951, we came back to a flexible interest rate.

Since we entered the free market in 1951, there have been shifts in the price of money depending upon the economic conditions. During periods of economic decline, the interest rates have declined. During periods of high levels of business activity, the interest rates have risen. This is because, in times of good business, people want to borrow more money.

In 1919, Mr. Glass warned that, if we did not have flexibility in the way in which the Treasury was able to borrow money in order to manage the debt of this country, there would come a time when we would be faced with real trouble. This time is at hand.

"RISING INTEREST RATES AND GOOD BUSINESS GO TOGETHER"

Setting price for bonds

Q. But wouldn't removal of the ceiling cause interest rates to rise?

A. I do not believe that they would rise because of this recommended change in law.

In the first place, while interest rates are influenced by Government borrowing, interest rates in free credit markets are by no means determined by the rates we put on our new issues of securities. It's the other way around: The rates we select are determined, after considerable study and consultation, on the basis of what's been going on in the market, the rates on existing Government securities, on corporate bonds, and the like. So, removing the ceiling would simply permit us to meet the market.

Secondly, since ability to do some long-term borrowing would help hold back inflation, removal of the 4¼-percent ceiling would tend to promote lower—not higher—rates of interest. Nothing shoots up interest rates as fast as fear of

inflation. That's one reason rates rose so fast in the summer of 1958. Investors are understandably reluctant to tie up their funds in long-term bonds if they believe the value of the dollar will go down. If they become convinced that we'll protect the value of the dollar, partly through sound debt management, they'll be more likely to buy long-term bonds at lower interest rates.

Finally, even if the ceiling were removed, we would not go into the long-term market for large amounts of money. We would be governed by the requirements of other borrowers—we wouldn't want to pinch them unduly—as to whether and as to when and as to what kind of money we borrowed beyond the 5-year term.

Q. Are interest rates really high today compared with the past? And compared with rates in other countries?

A. Of course, if you look back, interest rates were very low during the 1930's because there was little demand for money. During the war, most of the activities in this country were under direct controls and many people were buying Government securities—and Government securities were held at pegged prices because we were at war.

We had a short spell after the war in which we were operating most of our economy with relative freedom, but during most of that period we still had a peg on Government securities. Then we had Korea.

So it has only really been since the Korean conflict ended and we had accomplished the Treasury-Federal Reserve accord of 1951 that there has been a relatively free market. So, when people talk about what the interest rate ought to be, they are comparing it, to a large extent, with what occurred in the 1930's and the 1940's, during which we had either circumstances of great depression or war or controls or something else. Now interest rates in Canada are higher than they are here in the United States. Their rate on 3-month borrowing is now over 6 percent. In fact, our rates are lower in the United States than in any other advanced industrial nation where crédit markets are free.

Q. Are the interest rates higher in England than ours?

A. Yes, they are.

Q. What are some of the things that our Government could do to bring interest rates down, apart from changing the law?

A. It is true that the Government can do many things that an individual or business cannot do, and some of these things might appear to be the answers to our problems. Let's consider the consequences of some of these alternatives.

We know that interest rates are always lower when business activity is declining. This is partly because people are not so anxious to borrow money when the outlook is uncertain. I could assure you that a recession would bring interest rates down. But a recession is the very thing we're trying to avoid. What is important to understand is that rising interest rates and good business go together. We have been in a period of rapidly expanding business, with output, employment and incomes rising to new records. Under these conditions, many people want to borrow—to buy automobiles, to build houses, to expand factories—for many, many reasons. There are more people wanting to borrow than people who want to lend. So money becomes scarce, and interest rates go up.

Which had we rather have? The low interest rates of a period of depression? Or the somewhat higher interest rates of a booming, prosperous economy, in which employment is high and incomes are rising? I think the choice is obvious.

"Creation of money"

Q. Is there anything else the Government could do to bring down interest rates?

A. Yes. We might temporarily bring interest rates down by borrowing large amounts of funds from the commercial banks or the Federal Reserve banks. These two methods have something in common; they involve creation of additional money to meet the Government's needs. When commercial banks buy $1 of Government securities, $1 in new deposits are created. When the Federal Reserve banks buy $1 of our securities, they provide the basis for about $6 in new deposits.

That leads to inflation. It's what we've had in the past 20 years, as the dollar has lost half of its value. It's what we must avoid in the future, if our country is to remain strong and healthy and if we are to protect the value of our savings.

Q. We read that some people would like to force the Federal Reserve System to peg the prices of Government securities. Wouldn't this help bring interest rates down?

A. It might, temporarily. But the inflationary dangers would be great. We tried this system during World War II and for about 6 years after the war. It nearly led to disaster. It became so inflationary, after the outbreak of fighting in Korea, that the Treasury and the Federal Reserve agreed that the program had to be stopped, that its costs to the American citizen were simply too high. This would be one of the worst things we could do; it could turn the Federal Reserve System into a very high powered engine of inflation.

Q. I gather that there's nothing we can do to bring down interest rates without running the risk of serious inflation. Is that correct?

A. Not quite. We could adopt one of these techniques, even though it would be highly inflationary, and then try to offset the effects through direct controls—price controls, rationing, allocation of materials and labor, and so on. This type of regimentation of the economy worked in wartime, but it wouldn't work today. The American people wouldn't stand for it.

Incidentally, this is an interesting illustration of how controls breed more controls. The old 1918 law on interest rates is an attempt at a direct control—a control over the price of money. By keeping it on the statute books, we have gotten into trouble, and some of the ways out of this trouble would push us further toward a controlled economy.

There is, however, a sound, acceptable way for reducing pressures on interest rates. If we handle our financial affairs properly, by achieving a surplus in the budget and by permitting the Treasury to manage the debt flexibly, there would be less pressure on interest rates. The surplus would enable the Treasury to retire debt; that would add funds to credit markets, not use them up. And if we could manage the debt flexibly, without the complicating, hamstringing effect of the 1918 statute, we could instill additional confidence in our currency, and this confidence would help keep interest rates from rising.

Q. How has this interest rate become such a political issue in this country? And, if it doesn't get resolved in this session of Congress, is there a real danger? What are the prospects?

A. The problem of the management of the national debt is too important to all Americans to be viewed from any basis but the national interest.

All we are asking in our current legislative request is that the Government be allowed to borrow over-5-year money in a free market—as every other individual or company or municipality can borrow money in a free market. This is not legislation to increase interest rates.

TREASURY SHOULD "COMPETE IN THE MARKET" FOR LONG-TERM FUNDS

Alternative "controls"

Q. Are you speaking now of the bill that is pending in Congress?

A. Yes. As I said before, one of the things that we cannot do, unless we want to enter into a whole series of controls across the economic spectrum, is to repeal the quotations which are in the marketplace right at this moment, whether it is for Government securities or for something else.

So long as people can go and buy a Government security at a yield of above 4¼ percent, they are not going to buy a brandnew Government security with a coupon rate of 4¼ percent. The same is true of all other kinds of securities.

Q. Why do you think Congress doesn't give you that power? What is their objection?

A. I think there is some misunderstanding that, when you take off what is a statutory ceiling of the coupon rate of interest that the Government can place on certain securities—there is a feeling that this is legislating interest rates up.

As I mentioned before, this is simply not so. It is simply allowing the Government to compete in the market for long-term securities, like every other borrower, because today our long-term securities, in several instances, are yielding more than 4¼ percent.

You cannot avoid realism, and if we want arbitrarily to achieve a lower rate of interest for Government securities, if this is a specific objective, then we would have to resort again to an undesirable alternative such as Federal Reserve pegging of bond rates, which would be just as hazardous now—more hazardous than it was during the period that Mr. Eccles refers to.

Q. What effect does Government guarantee of mortgages and certain other securities have on the Treasury's ability to sell bonds?

A. In 1946 we had about $6 billion of obligations over 10 years to original maturity that were outstanding, on which there was some form of Government guarantee—or indirectly supported by the Government in some other way.

Since 1946, it has risen to almost $60 billion. Those securities, for the most part, bear higher rates of interest than the normal Government security. In some instances they are guaranteed and are at the same time issued by political subdivision of States, so that they are tax-free. We have simply created that much additional competition for our regular securities, and anything we add to it in the future is going to be additional competition.

There is no way for the Government to issue any kind of obligation by any subdivision or agency without increasing the competition that we would have from the securities that are sold in order to provide funds for the U.S. Government and to cover refunding of maturing debt.

What's ahead for budget

Q. Is the budget bound to increase because of the fact that wages and prices are going up?

A. I hope not—but I think, on the other hand, that, if we are going to avoid an increase, we have to make a very careful evaluation of what are the requirements of our country and how much of the desirable things we do in a given time.

Q. In other words, we may have to get to a point of beginning to deny ourselves things in order to keep the budget down?

A. Yes; we can't have everything we want at the same time.

Q. And doesn't that mean, really, that a rise in prices and a rise in wages are going to present you with a real problem of how big your budgets can be in the next few years?

A. Any increase in costs is going to present that problem.

Q. Is that going to affect the purchasing power of the dollar again?

A. It depends again on whether or not we have ample revenues to cover spending, and as to whether or not the Government is a net borrower of funds, or whether it is a net contributor of funds through the repayment of debt, or whether it just stays even by maintaining a balanced budget and nothing more. It depends also on whether we are willing and able to pursue sound and flexible monetary and debt-management policies.

Q. Why do you feel, Mr. Secretary, that people have so much fear of inflation at a time when, as you say, you have had relative stability in the price level and in the value of the dollar for a year to 18 months? Why is there all this concern?

A. Because people do not simply look back at the happening of events over the past 6 months or 12 months. An investor, particularly, looks over a longer period of time—what has occurred in 5 years, what has occurred in 10 years, and what he thinks may happen in the future.

This period of relative stability that we have now was purchased in part at the price of the recession that we had a year ago. Nothing impedes progress more than recessions, and if you want to avoid them, you try to achieve lasting stability. You try to achieve a rate of growth that you can sustain, and to avoid going up to great peaks of economic activity and sudden falling off to troughs of recession.

Q. Doesn't the stock market contribute to this feeling people have that there's going to be perpetual inflation?

A. The turn in events came back a year ago when people began to believe that certain things might be so: first, that we were out of the recession and were going into a period of rapidly expanding activity; second, that we were going to have a very large deficit; third, that we were going to have to finance that deficit during a period of rising business when there were other demands for money.

Accordingly, they began to act upon those expectations. Now, if those expectations in a shorter period of time had proven to be wrong, there would have been a reversal.

Q. But they were proved right, weren't they?

A. Yes; these expectations proved to be correct, and they are still correct. We did have to finance the deficit during a period of rapidly rising activity. The economy has been setting new highs every month. Demands for credit and borrowing in all sectors of the market have been rapidly expanding.

"SUBSTANTIAL TAX REDUCTIONS IN NEAR FUTURE" ARE UNLIKELY

"Avoid undue pressure"

Q. Aren't you going to come close to balancing the budget this year?

A. I think we'll have a balanced budget. If we are able to demonstrate that we are going to have a balanced budget in a period of high levels of business activity, if we can look forward to the generation of some surplus, if we can manage the debt flexibly so as to avoid putting undue pressure on any segment of the market, if we are therefore able to maintain reasonably stable prices and a sound relationship between wage increases and productivity, then I think that there will be a growing confidence that you can have a high rate of economic growth and reasonable price stability.

Q. Do you think that these things will happen?

A. They can happen if we all work hard toward them. It depends on how wisely we manage our affairs.

Q. Do you think public opinion is a factor in most of those "ifs"?

A. Oh, yes.

Q. An informed public opinion——

A. An informed public opinion.

Q. Versus a political misrepresentation?

A. These are matters on which sincere people can have honest differences of opinion. But, in my judgment, the people must be convinced that we have both the will and the capacity to control inflationary pressures in our country and that we are going to do so within reasonable limits.

Q. But there's a school of thought that's preaching more inflation, and insisting upon more spending. That group has by no means retracted its point of view that we'll make progress by more and more spending——

A. I simply do not agree with those people who assert that some inflation is the price of progress in our country. If we manage our affairs wisely, there is no reason why we can't have a high rate of progress and growth without inflation. In fact, we can't have real progress with inflation.

Q. Mr. Secretary, if we are to have any debt retirement, do we have to give up any idea of tax reduction in the near future?

A. I would say that this is so for right now, anyway. If expenditures are going to remain at anything like present levels, then I think in order to have money for debt retirement one cannot expect substantial tax reductions in the near future.

Q. If the interest rate goes up, does this cause prices to rise, because interest is a cost of doing business?

A. No, not in my judgment. Interest is a relatively small cost in manufacturing operations, somewhat less than 1 percent of total sales, I believe. Consequently, even a doubling of interest rates would have only a very minor effect as a cost of operations, in this case.

What is more important to realize is that rising interest rates are a sign that not all people are able to borrow as much money as they would like to borrow; in other words, the amount of credit to be used for spending is being restrained. Thus, the decidedly minor impact of interest as a cost has to be weighed against the much more important aspect of interest rates as a sign of effective credit restraint.

Q. But isn't the interest charge a very important part of the cost of buying a house?

A. Insofar as the monthly payment is concerned, not nearly so important as some people seem to think. For a moderately priced house, a one-point increase in the interest rate results in an increase of only a few dollars in the monthly payment.

From the standpoint of the average home buyer, the rise in interest rates since the end of World War II has not been nearly so important as the rise in construction costs. For example, a house that cost $10,000 in 1946 would cost about $20,000 today. Its price has doubled almost wholly because of inflation in construction costs.

In 1946, the house could have been purchased for a monthly payment of about $51; now, the payment would be about $115. But, of the $64 increase in monthly payments, $58 reflects the cost of inflation and only $6 can be attributed directly to the rise in interest rates.

Inflation is much more of a consideration to the prospective home buyer than is the cost of money.

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If "Cold War" ends

Q. Now, judging from what the newspapers have been saying, some of the comments in the last few days, and by the way the stock market has been behaving—the assumption that maybe the cold war is going to end, defense spending is going to be materially reduced and very sharply curtailed—what effect is that going to have on interest rates, on Government receipts, taxes?

A. In an economy as complex as ours, all of the interpretations of people have an effect. It is the net result of a great multiplicity of millions of decisions by people. They all have some effect. It is very difficult to pinpoint and say what the precise effect is going to be or how long it's going to endure.

However, a relaxation of the type of pressures you refer to should have a favorable impact on interest rates and the Government's fiscal position.

Q. Yes! but wouldn't that be a colossal if the armament program were suddenly made unnecessary by the "brotherly love" doctrines that are now being preached?

A. While there may be different assessments of the degree of the cold war, I think realistically we have to live with the possibility that the uncertainty is going to be with us for an unknowable period of time.

Q. You don't look for a sudden ending of our armament program, then?

A. Not sudden.

Q. Mr. Secretary, from time to time some source starts the rumor that the value of gold will be increased in relation to the dollar, and the dollar devalued to that extent. Does that remain out of the question?

A. Yes, completely out of the question.

Q. Would you say that, if one of the prices of economic stability is a very sharp rise in interest rates, that kind of stability is worth the price?

A. Without trying to relate it to "sharp," I would simply say that, if we want to continue to operate in free and uncontrolled markets, then we have to be willing, during times of high levels of business activity, to let the Government pay the same price for money that other people pay in the free market; and that, if we try to artificially reduce that price by reliance upon money creation—either through the commercial banks or through the central bank—we are doing a very unwise thing.

Q. To what degree would you say that forces outside the Government might play a part in producing a lower purchasing power of the dollar? Would you say that that is as great a factor as the Government itself? The decline of the dollar——

A. Undoubtedly the creation of credit of all types has an important effect, and this is, again, a situation in which we have to have a measure of self-discipline. We have to have discipline in the conduct of our own individual affairs, discipline in the conduct of our fiscal affairs and discipline in the conduct of our monetary affars, and they all play a part.

Q. And if one of those factors—particularly in the economic life of the country which is not controlled by the Government—should get out of hand, might it undo much of the good you may be doing in the other factors?

A. Again, you simply have to maintain disciplines in all of them. We must always remember that disciplines are not easy and that hard choices must be made. Freedom is not free—it must be earned.

Q. Isn't the wage-price spiral really what's beating you, despite everything you can do? If this wage-price spiral keeps up uncontrolled, aren't you licked anyhow on maintaing the purchasing power of the dollar?

A. This comes right back to the proposition that increases in wages have to be associated with sound increases in productivity. As long as you can maintain a sound relationship between the two, then you can be reasonably secure. If that relationship is not maintained, then you have difficulty.

Q. Might not one of those difficulties be another recession rather than further inflation?

A. Whether it be in the scope of the Government or in the scope of nongovernmental activity, anything that you do which generates inflation or the fear of inflation, or which promotes a rate of growth over a short period of time that is not maintainable, sows the seeds of some future recessions, and it is for the avoidance of those kinds of recessions that all of us ought to maintain some reasonable disciplines in our conduct.

Q. The returns from increased productivity must go to investment in machinery as well as to labor, must they not?

A. There must be a fair distribution. And we shouldn't forget the consumer. He's entitled to some of the benefits of greater efficiency in production.

"WE CANNOT LEGISLATE CONFIDENCE IN THE DOLLAR"

Q. What is your feeling about the relationship of the dollar to other currencies of the world?

A. The dollar is the best measure of value in the entire world. We must keep it so, and manage our affairs so as not to allow a lack of confidence to develop. Certainly, as we look over the past several months and see that the foreign holdings of our securities have been rising, this dispels any idea that there has been any lack of confidence. But, again, our problem is to so manage our affairs that we maintain confidence and not wait until it is impaired and then try to rebuild it. We cannot legislate confidence in the dollar; we must earn it.

Q. If you had to sum up the future of the American dollar as to what's going to happen—not what you would like to see happen, but what's going to happen in the next 5 years—do you think the dollar is going to remain stable or do you think it's going to be under attack from all these forces that influence it?

A. We have before us the greatest opportunity in history. We are a rich country with vast resources. We occupy a leading position among the nations of the world. All that is required of us is that we are wise enough to manage our affairs capably, that we do not abuse the expansion of credit for the Government or anyone else, and that we abide by the disciplines of economics that the past has proven to be sound.

And, if we will do that, there is no reason why we do not stand on the threshold of the greatest opportunity that this Nation has ever known.

Mr. PATMAN. Now, what are the facts? That is not true at all, according to the Federal Reserve annual report for 1958. I will read on page 118 to the effect that in 1945 the Federal owned 24.2 million U.S. securities; 1946, 23.3 billion, it was reduced; 1947, 22.5 billion, reduced; 1948, 23.3 billion, reduced; 1949, 18.8 billion, considerably reduced; in 1950, 20.7.

So that propaganda is absolutely untrue, Mr. Ruttenberg. The reason I invite it to your attention is because you are on this important Committee of CED, a committee that is doing work that a congressional committee should do.

Mr. RUTTENBERG. May I correct just one thing, Congressman Patman. Please do not refer to the Commission on Money and Credit as the CED commission because it is not. If it is the CED commission I would resign from it today. I would never have accepted appointment to it had it been a CED commission. The CED instigated it, but the funds supporting it are coming from the Ford Foundation.

Representative PATMAN. I am glad to have that explanation. I hope you keep these things in mind because they are important. The newspapers, even fine papers in our country, and the magazines, are not correcting these things. I wish they would, but they are not.

Mr. RUTTENBERG. The other thing that worries me on the high interest rate policy is the current argument which is being made and heard more frequently day in and day out by bankers and some administration people, and certainly has been reported quite accurately by Mr. Daly in the New York Times, that come a recession in America, the Government should be careful about following an easy money policy because this might lead to a further difficulty in our foreign balance of payments situation.

I am worried that the buildup now is for a continuation of high interest rates even in a recession because of this fear, not because it is a fear of reality in my judgment, but because it is a basis of being able to maintain over a period of time, recession or no recession, prosperity or no prosperity, a high interest rate policy.

I am terriby worried about this kind of propaganda that is going on now.

Representative PATMAN. Mr. Curtis is recognized.

Representative CURTIS. Mr. Chairman, I regret our schedule if we are going to follow it will not permit any questions because we have someone due at 11, and the statement was made that he had another engagement later. There are many things that I would like to ask questions about.

I have had a chance to glance through the 45-page statement of Mr. Reuther. I guess I will have to content my self by saying that I find it full of logical flaws and I question a great deal of the data. I wish I had the opportunity of interrogating the witness on it.

Representative PATMAN. You are recognized for 10 minutes.

Representative CURTIS. I understand that, but I also understand we have a schedule that calls for other witnesses, one beginning at 11 o'clock and it is now 11:15. In fairness to those other witnesses, I am going to refrain from asking any questions.

Representative PATMAN. Without objection, we will hear from Mr. Schmidt; is that right?

Do you want to ask any questions, Mr. Kilburn?

Representative KILBURN. I do not.

Representative PATMAN. Senator Javits?

Senator JAVITS. Yes, I would like to ask one or two. I apologize to the other witnesses. I did not know they were waiting.

I had one fundamental question, and that is on the question on productivity. Is it your though that any measures are required in our country of a nature which deals with the relations between management and labor such, for example, as undertaking automation and at the same time being sure that the worker will not be treated as some item of property in that regard? That his interests will be safeguarded?

Or do you believe on the other hand that problems of productivity are strictly tied to monetary and fiscal management and that if those policies are changed, productivity will take care of itself?

Mr. RUTTENBERG. No, Senator, I do not agree with the latter point of view. I agree with the former point of view which you expressed. I would like to call attention to the fact that in Mr. Reuther's statement on page 43, his point No. 14 suggests the possibility of a national commission on technological change to be composed of representatives of labor, farmers and management, consumers, so that it might keep under continuing review the developments in automation, atomic and solar energy, and other technological innovations, and continually make recommendations to the Congress and the President of the United States in this important area.

I think it is an area that needs careful attention and study and what we do monetarywise, fiscalwise, budgetwise, other economic policies, may or may not have some indirect relationship to it. But automation and technological advance and productivity remains a problem to itself.

Senator JAVITS. I propose the possibility of reviving on a local level—I like this very much, let me tell you—the idea of a top commission, productivity councils. Labor-management productivity councils such as we had during the war.

I would appreciate it very much if I could submit that in writing, if we could have for the record the point of view of the AFL–CIO on that proposal. I would submit the details of the proposal as a question so that you will be able to give it some mature judgment and let me have your point of view.

Mr. RUTTENBERG. I would be happy to do that, Senator Javits. It seems to me that you wrote a letter a year or so ago to the president of the AFL–CIO asking for comments.

Senator JAVITS. If we have them adequately, I will be satisfied.

The next point is on imports. There is a considerable problem going on in the country and in the unions and in the top federation, and people like myself who have a deep interest in a liberalized trade policy because of its essentiality to the national interest and to the peace leadership of the United States, about what is and will be the attitude of the unions.

Of course, you are so familiar with the classic arguments on both sides and I would be presumptuous to repeat them, but I do feel it would be interesting to get from you for the record some articulation of the trade union policy as the top federation sees it.

I am sure you know that the Amalgamated Clothing Workers are now rather exercised about a considerable change in policy they have adopted and they have rather looked with favor upon restrictive legislation with respect to imports which they would not have countenanced heretofore because they feel competition, especially from Hong Kong, very keenly.

This is of burning interest especially to people like myself. I have advocated and other Congressmen and Senators have advocated assistance. There is some formulation of this idea of unfair competition between very low-paid labor and American labor as it affects the consumer who is also entitled to serious consideration.

Again, I will not press you for an answer now because this is a matter of very high policy, but I would hope for the record you could give us an articulation of the views of the federation on this subject.

Mr. RUTTENBERG. Might I just say, Senator, that this is a subject to which I personally have devoted a substantial part of my time in the last 15 or 20 years in the trade union movement.

Our federation, the AFL–CIO, has given serious consideration to these problems of imports and to the Amalgamated Clothing Workers as well as the International Ladies Garment Workers. I took a 10-week tour through southeast Asia, including Hong Kong and Japan with specific importance on the impact of those areas.

We do have some views and we would be glad to submit them for the record.

Senator JAVITS. Thank you.

Thank you, Mr. Chairman.

Representative PATMAN. Thank you, Mr. Ruttenberg, for your statement.

Mr. Emerson Schmidt of the U.S. Chamber of Commerce. I notice you have a prepared statement. Would you like to read the statement in its entirety or would you like to file it in the record at this point and then summarize it?

STATEMENT OF EMERSON P. SCHMIDT, CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA

Mr. SCHMIDT. In the interest of brevity, Mr. Chairman, you can insert it in the record and I will touch on a few high points.

Representative PATMAN. Without objection, it will go in the record at this point.

(The statement referred to follows:)

STATEMENT OF EMERSON P. SCHMIDT, DIRECTOR OF ECONOMIC RESEARCH, CHAMBER OF COMMERCE OF THE UNITED STATES

I am Emerson P. Schmidt, director of economic research of the Chamber of Commerce of the United States. I am here at the invitation of the committee to discuss the Economic Report of the President and the issues relating thereto. We appreciate the opportunity of this annual visit with your committee.

The 1960 Economic Report, in many respects, represents an improvement over its predecessors, although several shortcomings merit notice.

The report contains a great deal of helpful analysis, much useful, factual information, and excellent statistical series. The general reader will, perhaps, find most interesting chapter 1, "Economic Growth in a Free Society"; this sets the tone for most of what follows, although it carries some questionable conclusions. The report is growth oriented, as it should be.

THE ECONOMIC SITUATION: PAST AND PROSPECTIVE

Because of the recent shift in our international payments position which presents us with a potentially critical problem, the materials in the report on this subject may call for the most urgent attention of the committee members and other serious students (pp. 29–38 and the sec. IV of app. B, beginning on p. 111). Some new analysis and data, not heretofore generally available, are brought together there.

Most of the rest of the report, dealing with last year's economic developments and policies and the legislative program for the year ahead, follow more traditional patterns, although this does not detract from their usefulness. Much of the material in the appendixes dealing with population, growth, employment and earnings, agriculture, diffusion of well-being, bring together a wealth of useful information and interpretation.

The many tables and charts throughout the report and the nearly 100 pages of statistical time series relating to income, employment, and production, etc., present a large amount of useful material (app. D). They bring together, in the covers of one volume, an abundance of information which throws light on what has been happening to us and our economy in the last generation.

IMPACT OF THE STEEL STRIKE

The Economic Report, both in looking ahead and in analyzing recent trends, finds it necessary to allude to the disruptive effects of the steel strike in each chapter and the major sections of the report.

Economic analysts in the past year have been handicapped by the disturbing economic effects of the near-industrywide bargaining in the steel strike. Expiration of the steel contracts, as well as some others, last summer, with the possibility of a paralyzing strike occurring, led to a precautionary inventory accumulation boom in the first half of 1959; this distorted the figures and provided a false sense of buoyancy and optimism, unless duly discounted. The subsequent 116-day strike, which began on July 15, soon started to pull the economy down; in the third quarter of 1959 gross national product actually declined from the second quarter by $5.9 billion instead of rising by $10 or $12 billion per quarter, as had been the case beginning with early 1958. The steel strike quickly distorted the gross national product figures and many others, making it more difficult to read the economic signs of the times.

For some months ahead, we shall pass through an inventory-rebuilding boom, as well as a production boom, backed up by the catching-up phases in autos, construction, etc. This, again, makes statistical analysis of where we are in

the business cycle more difficult than is normally the case; yet, the Employment Act of 1946 and your committee are concerned primarily with sustained prosperity.

The report's expectation of "an extension of growth through 1960 and beyond" is in general agreement with most other analysts, although it would have been helpful if more evaluation of divergent forces had been provided.

The steel strike probably has postponed the next downturn, but at great cost to those who suffered from it, a downturn which, statistically speaking, could have come next October (since the average expansion period in 25 cycles since 1854 has been 30 months and the current expansion began in April of 1958).

But, as the report points out, sustained prosperity and growth have to be earned; they are not guaranteed "free of charge" for once and all. Possibly, the report should have done more to prepare us for the next readjustment. The time to prepare for trouble is before it comes and if trouble spots can be anticipated, disruptive readjustments may be mitigated or possibly avoided.

GROWTH

Throughout the report there is much discussion of economic growth, incentives, proper and improper public and private policies. This is as it should be.

It is just possible that the American people are getting about the rate of economic growth they want, in spite of innumerable public complaints and much pouting over our "slow growth." Growth is a good thing. But it has its cost. More growth could mean giving up some leisure. For example, growth generally does not mean more of the same thing, but it means new things. And it may even mean abandoning old things and old practices. It may mean a rise in short-run structural unemployment. If we want more growth, we need more flexibility and competitive adjustments and less restrictive legislation.

While such shifts have overall beneficial effects, they may be painful to investors, owners, and workers in the transition. We should not raise false expectations. These matters, including the problems of hard choices, are discussed at length in our recent "The Promise of Economic Growth: Prospects, Costs, Conditions." It would have been helpful if the Economic Report, so much concerned with more growth, would have dug somewhat more deeply into the roadblocks to, and costs of, growth, both in the private sector of the economy and in the public sector.

The report properly emphasizes the importance of new private investment, if we want more growth. Improved technology and more skilled labor and management are on the side of growth and higher productivity.

The report urges the elimination of "wasteful practices" but it does not identify them or attempt to measure them (p. 7). Elsewhere attempts have been made to quantify featherbedding and other wasteful practices; in the case of the railroads, the estimates run over $500 million per year. It would be most helpful if we had estimates for other industry groups, particularly construction, printing, and some phases of the entertainment world, etc. This is suggested for consideration by the Joint Economic Committee and for future Economic Reports of the President, because by means of such identification and quantification public opinion can be brought to bear more effectively on the issue. It is easy and costless to take a stand against wasteful practices in general; it takes much more effort to define them, identify them, and to measure and quantify them.

In other words, if we are serious about wanting more growth, we ought to be sufficiently forthright to be specific about getting the facts and evaluating them.

TEST FOR PUBLIC EXPENDITURES

The principle of efficient utilization of resources, the report stresses, applies with equal force to the Government sectors of our society. The report properly states:

"The public use of funds, whether to continue established programs or to initiate new ones, must be justified on the ground that it makes a larger contribution to well-being and economic strength than could be made by their private use. The entire range of Federal spending must be continuously under review, with this criterion in mind * * *" (p. 6).

This admonition is a sound principle and is in conformity with the report of your Subcommittee on Fiscal Policy entitled "Federal Expenditure Policies for Economic Growth and Stability," which you published in January 1958. We

said before this committee 2 years ago that every Member of Congress should read or reread this report most carefully. We called it a democratic manifesto of fiscal integrity and good sense. We even predicted that it will become a landmark as a public statement of principle and will be widely quoted, cited, and reprinted in the future. Possibly, our enthusiasm for the quality of your analysis and principles was excessively hopeful. But we would like to reiterate our recommendation for a wide readership of your report.

But implementing this standard or criterion is a major challenge. The wider resort to user charges in Government programs, as recommended in the Economic Report, is a step in the right direction. Another example was the movement toward toll roads, but now largely abandoned for future highway programs.

As one of your committee members pointed out in a recent address, the private enterprise system, in effect, uses the marketplace as the equivalent of a scientist's laboratory; there, economic ideas (goods and services) are tested. They must prove their worth without force or coercion in the free-choice market (address before Associated General Contractors of Missouri, by Thomas B. Curtis, Jan. 14, 1960).

The challenge: How can the Congress in legislating, and Government bureaus in applying general legislation, make decisions which will assure that the public use of tax dollars yields values greater than those generated by market-tested private expenditures?

Possibly, your committee should give consideration to directing your competent staff to prepare a report for you, after the close of the present session of the Congress, on ways and means of applying this test to Government operations and appropriations, as a sequel to the remarkable report your Fiscal Policy Subcommittee issued 2 years ago. Even modest initial progress in this direction would constitute a genuine contribution to all layers of Government for the period ahead, when the political and economic struggles over taxation will inevitably grow more tense and strenuous. Some initiative in this effort now, and continuing over the year, should help create much more rational foundations for public policy.

CONGRESSIONAL BUDGET PROCEDURES

Although congressional organization and procedures will not guarantee adequate perspective in evaluating the fiscal demands upon the National Government, they nevertheless can enable or inhibit effective judgment by the political branches of the Federal Government. The system which is used to make budgetary decisions in both their broad and detailed aspects is in need of immediate and major improvements. This must be accomplished if we are to establish proper priorities and avoid detrimental effects upon our economy and economic growth.

It is essential that Congress be provided with a mechanism which would enable it to take a more meaningful view of the total spending program and of the relationships between the spending program, revenues, and debt-management problems.

The practical effect of the present congressional system for acting upon financial matters is to thwart overall evaluation. Congress cannot properly assess individual programs and establish spending priorities when the spending program is enacted through 12 to 17 appropriation bills and several pieces of substantive legislation carrying authorizations to obligate and/or expend funds. Nor can we reasonably guide such decisions to avoid serious economic consequences when added to this piecemeal consideration of the spending program we deal separately and at different times with other major aspects of the Government's budgetary and financial problems such as those dealing with revenue and debt management.

There is definite need to establish a congressional "center of financial management" which would consider all aspects of the budget. It is equally imperative that Congress remedy the piecemeal approach to spending and give the omnibus bill method—or two appropriation bills, one for national defense and a second for all other functions of government—a fair and reasonable trial.

The continued development and use of "back door" spending methods to avoid normal budgetary review and control should be discontinued. All authorizations to obligate and spend funds should be by appropriation only and Congress should adopt remedial measures. There are actions pending in both the House and Senate which could eliminate this problem most effectively.

Finally, it must be pointed out that the financial reporting of congressional actions on budget and financial matters is woefully deficient. It is extremely confusing to the public, and must be to the Congress, to find at the end of each session numerous versions of the budgetary actions which Congress has taken. These generally stem from the use of different reporting bases. A uniform, standard system of reporting which provides meaningful data, including all spending authorizations enacted, should be undertaken immediately.

A year ago we commended the announcement in the President's Economic Report of the plan to set up a Committee on Government Activities Affecting Prices and Costs, which was to scrutinize relevant National Government programs such as procurement, construction, stockpiling, subsidies, price supports, etc., for their waste and inflationary potential. It is disappointing that there is no reference in this year's Economic Report to the accomplishments, if any, of this committee or any future plans for it; here was a golden opportunity for various Government agencies to work together to reduce waste and uneconomic practices in the national establishment.

Our agricultural programs have become a national scandal. Were we not so rich, the fabulous waste of human and other resources perpetuated by several governmental agricultural programs would have long ago brought their own demise.

In fact, if we grant the wisdom of a consumer-oriented economy, waste cannot continue for long except with the aid of Government, whether in the private or the public sector. Competitive forces, when and where allowed to become effective, are powerful in cutting down waste and promoting growth.

It does not make much sense for the Congress to seek out inflationary "scapegoats" in the private sector of our economy when through a host of programs and activities the Government continues to tolerate, and even create and justify, many of the seriously wasteful and inflationary pressures which 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 responsibility in the field of growth retardation and inflationary pressures.

As an illustration of how we all are victims of inflation, note what has happened to the price of the Economic Reports since 1946:

Council's First Annual Report, December 1946, 26 pages, 10 cents.
President's Report, January 1947, 54 pages, 15 cents.
President's Report, July 1947, 82 pages, 25 cents.
Council's Second Annual Report, December 1947, 29 pages, 15 cents.
President's Report, January 1948, 136 pages, 35 cents.
President's Report, July 1948, 115 pages, 30 cents.
President's Report, January 1949, 140 pages, 45 cents.
President's Report, July 1949, 126 pages, 50 cents.
President's Report, January 1950, 194 pages, 50 cents.
President's Report, July 1950, 160 pages, 40 cents.
President's Report, January 1951, 241 pages, 50 cents.
President's Report, July 1951, 278 pages, 65 cents.
President's Report, January 1952, 220 pages, 55 cents.
President's Report, July 1952, 188 pages, 50 cents.
President's Report, January 1953, 218 pages, 50 cents.
President's Report, January 1954, 225 pages, 65 cents.
President's Report, January 1955, 203 pages, 60 cents.
President's Report, January 1956, 238 pages, 70 cents.
President's Report, January 1957, 200 pages, 65 cents.
President's Report, January 1958, 199 pages, 65 cents.
President's Report, January 1959, 225 pages, 75 cents.
President's Report, January 1960, 243 pages, $1.

It should be added, of course, that a rise in quality or quantity, other things being equal, is itself the equivalent of a fall in price.

Let us look at a few cases of Government programs which should be reexamined in terms of priorities and essentiality.

The Economic Report requests legislation to revise the outmoded provisions of the 8-hour laws applying to Federal and certain federally assisted construction projects. But, as a case in point, why should we have a series of different 8-hour laws? Why three separate wage-and-hour laws and agencies or staffs administering minimum wage laws, such as under the Fair Labor Standards Act, the Walsh-Healey Act, the Davis-Bacon Act? Surely these depression-born

wage-and-hour fixing devices should be integrated into a single program as a minimum, or they should be terminated in an economy of high employment and expansion. Economic expansion and high-level employment will do more for the workingman than any amount of Government wage-and-hour fixing.

Another case:

Congressional committees, subcommittees, the entire Congress, as well as hundreds, perhaps thousands, of witnesses and industry people over the last 25 years have spent an enormous amount of time and energy and money considering and discussing housing and legislation related thereto, financing, and related problems. Had all this legislative activity not taken place, would our citizens be less well housed today, or would they be better housed? Would unit housing real costs be higher or lower?

The answers to these basic questions are not obvious. Yet, to a nonexpert, they would seem to be important.

For example, let use take a look at the accompanying table, which may help us to consider one of these basic questions.

Housing starts—With and without Government aid

Year	Nonfarm housing starts (thousands)	Gross national product (billions)		Population (thousands)	Housing starts per million dollars GNP 1954 prices	Housing starts per thousand population
		Current prices	1954 prices			
1925	937	$94.5	$161.8	115,832	5.79	8.09
1926	849	98.6	170.8	117,399	4.97	7.23
1955	1,329	397.5	392.7	165,270	3.38	8.04
1956	1,118	419.2	402.2	168,176	2.78	6.65

The table contrasts nonfarm housing starts in 2 prosperous years in the mid-1920's and 2 prosperous years in the mid-1950's. The figures show that 35 years ago, without Government intervention, we had over five new nonfarm housing starts per $1 million of GNP (in constant 1954 prices), as against only about three housing starts in the mid-1950's. Housing starts in the mid-1920's per thousand population were moderately higher than in the mid-1950's.

Offhand, this unfavorable showing for the Government interventionist period causes one to wonder whether all this congressional concern for housing was justified in the past 20 or 25 years, and whether its continuation in the future is wise, or necessary—particularly in the face of U.S. Treasury difficulties and proper legislative priorities.

These two pairs of figures may not be conclusive, and are included here only to suggest legislative and expenditure areas which might merit investigation by those concerned with priorities and with reducing the fearful overburdening of conscientious members of Congress.

Many other aid programs should be similarly examined. Aid to depressed areas is a case in point. This program, if adopted, might become within a few years a huge WPA program for business and could become a burden even greater than the agriculture program, and thus retard rather than stimulate growth. It could slow down necessary readjustments within our economy and encourage the avoidance of improving the job climate which in some cases holds down recovery, as we showed in our "Getting and Holding Good Employers."

Many other cases could be cited, some of which separately may be small but may amount to large figures in the aggregate.

TAX REFORM AND INVESTMENT

This brings us to the tax question. In terms of raising our real income, retarding inflation, and mitigating our balance of payments problems, this emphasis on efficiency, productivity, and waste elimination is important and urgent. More investment per worker in more advanced technology will help to meet some of these problems. But if we had the courage and willingness to reduce uneconomic practices by a wide margin, this would increase the productivity of existing facilities and stimulate additional investment.

Furthermore, as the report points out, within a few years the annual increment to our labor force will be double the average rise in the 1950's, which

came to about 825,000 workers per year. At $15,000 investment per job, this soon will call for over $20 billion per year of new investment—just to hold our own. If, in addition, we want to create better paying jobs (that is, more productive jobs) for the existing labor force, this calls for additional investment. Larger savings are required. Thus, tax reform, as well as waste reduction, become more important; they could make a substantial contribution to our real income.

The report points out that, "We grow only by investing more and producing more, not simply by spending more" (p. 6). Appendix C, on the "Diffusion of Well-Being, 1946–59," however, properly emphasizes the end product of new investment and other forces in benefiting our citizens broadly; but this emphasis on new investment is likely to grow more urgent in the years ahead.

Without recommending immediate tax reduction or tax reforms and, indeed, recommending some tax increases, the report urges that we "* * * remain alert to the possibility of making the tax system a more effective instrument for promoting economic growth."

The report recognizes that taxes affect the ability of individuals and corporations to save. Likewise, their impact on the risk and return of investment influences the willingness to make productive use of savings. Our tax system should give encouragement to productive effort and should facilitate the mobility and efficient use of capital.

Because of the inflationary potential in our economy and the budget situation, the report recommends no tax reduction at this time. But, fortunately, it does state that, "We should continue to review our tax system from these standpoints, as well as from the standpoint of equity."

While it is difficult to document the adverse effect of our present tax system on enterprise, ingenuity, initiative, and new investment, it is gratifying to note that the Economic Report urges a continuous review of our tax system.

It seems unfortunate that quite regularly, year after year, we are told that we need tax review and tax reform, but this is not the year to reduce taxes or to reform the tax structure. As long as the tax revenues flow in, the pressures and sentiments to eliminate less essential Government activities are reduced. This indisposition to engage this issue head on is causing a number of people to say, "Let us cut the taxes first, and then cut the appropriations in line with the reduction in tax revenue." Perhaps this would be the only way to cut out less essential Government activities and eliminate the waste. But we hasten to agree with the Economic Report when it points out that with high levels of current prosperity and incomes rising, the most appropriate fiscal policy is one that provides a sizable excess of Federal revenues over Federal expenditures. A surplus would add potential savings to the economy, would help to keep interest rates lower than otherwise, and facilitate private investment activity as well as State and local government projects.

Tax reform and tax cuts should not be foreclosed at this session of Congress; for example, if now is not the time to institute cuts, the cuts could be made effective as of some future date—say, January 1, 1961.

INTEREST RATE CEILING

The report's request of Congress to eliminate the ceiling on permissible interest rates on Government bonds in excess of 5 years' duration should be honored.

Money market experts and economists, generally, including the economists of your own committee special staff, have urged this step (staff report on "Employment, Growth, and Price Levels," Dec. 24, 1959).

It would be difficult to find objective scholars who would urge the retention of the ceiling. To retain the ceiling creates needless difficulties, while to work out some device for partial removal or exemption gives testimony to a certain unwillingness to face the issue directly; every observer, here and abroad, will see through such a facade.

It is, indeed, an anomaly for Congress to allow the Treasury to pay over 4¼ percent for short-term money and disallow the same on bonds.

The problems of Treasury finances are difficult enough without this artificial constraint, further complicating debt-management operations. Barring the U.S. Treasury from financing the debt through the entire range of the money markets is not responsible fiscal policymaking.

Furthermore, by forcing the Treasury to concentrate its financing in the short-term money markets, Congress has raised interest rates for a maximum number

of borrowers. Congress, furthermore, is raising the overall interest rates paid by the Treasury—that is, by taxpayers; this, at least, is the opinion of the President (p. 43), the Secretary of the Treasury, and Government economists. The ceiling has impaired the Treasury's ability to manage the debt with a minimum potential inflationary impact.

For these reasons, we, too, urge the prompt and permanent removal of the ceiling, with the hope that the issue can then be forgotten.

CREDIT RESTRAINT AND GROWTH

The Economic Report stresses the key role of savings in the growth process, but it could have provided a more useful discussion of the relations between growth and Federal Reserve bank policies and the relation between money savings, bank credit and the money supply. Here is much confusion.

It is most urgent that we do not overload monetary policy. We need understand its power and its limitations. Students of the business cycle have for many years emphasized the importance of having monetary and fiscal policy work in harness and not in conflict.

Critics of the Federal Reserve System, who accuse it of creating credit stringency, should, to be logical, criticize deficit spending and narrowly balanced Federal budgets during an inflationary period. They should urge higher taxes or reduced expenditures.

Critics, likewise, of the inflation-restraint policies, moreover, appear to have an exaggerated view of the importance of bank credit and of the Federal Reserve's power to "determine" interest rates in general. The Federal Reserve follows money market changes more often than it leads changes. But FED changes from time to time are more likely to make the news (except for open market operations) than the multitude of minor and more or less continuous changes in the innumerable private money markets and in lending institutions and transactions. Thus, appearances lead to dubious inferences and exaggerated notions of the influence of the FED.

The total demand and the total supply of loan funds determine the interest rate structure and levels at any given time; to be sure, any major change in supply of loan funds from any source may have a perceptible effect. One Senator stated that since 1913 the Federal Reserve has determined interest rates. This is not correct. That the role of the FED and commercial bank loans is exaggerated is indicated by a few figures. Bank credit is only a small fraction of the total volume of savings available for lending. Annual rates of increase in the money supply, including demand deposits and currency but excluding time deposits, have averaged about $3 billion in the past decade. Changes have seldom exceeded $6 billion in any one year, although a decrease is rare. These changes in the creation of additional money by the banking system are small relative to the annual increases in the total of all credit, which have ranged in the past decade from $30 billion to somewhat more than $50 billion, with an average of nearly $40 billion. For further analysis see "The Controversy Over Interest Rates," address by Woodlief Thomas, January 20, 1960.

The tail does not wag the dog.

The Economic Report, furthermore, does not analyze the error of those who confuse the supply of loan funds, including the cost of borrowed money, with the money supply. The point that David Hume made 200 years ago that a sudden, once for all rise in the money supply would not bring down interest rates holds true today, particularly in a capacity-operating economy, despite our more complicated debt structure and financial system. It is the real forces—productivity of capital and level of saving—that determine interest rates.

Because these relationships are complicated and subject to much current confusion, the Economic Report missed an opportunity to help clarify the issues. Its emphasis on making the integrity of the dollar a goal of the Employment Act of 1946, however, should receive the serious attention of your committee.

INTERNATIONAL ECONOMIC RELATIONS

The discussion of our foreign economic relations and, in particular, of our balance of payments position, its origins, and its prospects, is to be commended. We heartily concur with the report's policy emphasis: "Stronger efforts must be made at this time to expand U.S. exports of goods and services. Fiscal and monetary policies designed to restrain inflation provide a solid basis for such

efforts. but more needs to be done to strengthen the competitive position of our exports."

There are, however, surprising omissions in the analysis of our balance of payments problems. There is no analysis of a possible serious conflict between our international payments position with domestic stabilization problems, in particular those of monetary and credit policy. There is no mention of the constraints imposed on domestic stabilization policy by the greatly increased volume of foreign-held short-term dollar assets. In a recession, the appropriate policy for us of credit ease would result in falling interest rates and increased financial liquidity. But, if domestic short-term interest rates should fall much below rates in foreign money markets (as would happen were the rest of the world still in a state of boom), substantial outflows of gold and dollars would result. As one of the witnesses before this committee, in discussing the prospects stated last June 30: "The abnormal state of the last 25 years in which we could fashion our domestic and foreign policy in complete disregard of our balance of payments * * * " will have passed. Failure to discuss this matter is a serious gap in the Economic Report.

The report recommends various steps to increase our exports, including intensified use of Department of Commerce facilities for disseminating foreign trade information, strengthened commercial activities of our Foreign Service, more trade missions abroad, and expanded participation in trade fairs. The report on this point may strike too optimistic a tone. It is true that the decline in our exports has been concentrated in a few commodities; that we have retained, or increased, our share of other markets; but it is always thus. Some of our prices rise relative to foreign prices; some fall; we are always pricing ourselves out of some commodities, and into other commodities. This really is not the issue. It is the net balance of weighted price changes, reflected in the balance of trade, which is the significant index of our relative performance. The major imbalance between our total receipts and payments is the cause for concern.

In addition to intensified information efforts, the report states that "* * * The United States intends to continue encouraging the removal of remaining restrictions on imports from the dollar area. * * *" This is sound. It also will continue urging other advanced countries to share the burden of aid to underdeveloped nations and to assume a larger proportion of the costs of common defense.

There is no indication in the report however, whether these measures will be adequate to correct our balance of payments problems, nor what causes other than those indicated by these correctives may require consideration, and what further measures might be recommended. The report does not tell us whether the trade imbalance is the significant matter, or the overall imbalance in payments and receipts. It is the imbalance in the latter which is the real test of "pricing ourselves out of the market."

PRODUCTIVITY AND WAGE SETTLEMENTS

The Economic Report, in analyzing wage changes, productivity and the settlement of strikes, is not very useful. In fact, the analysis may do some damage.

Of what use to management or union officials is the statement that wage settlements "* * * should not be such as to cause the national average of wage rate increases to exceed sustainable rates of improvement in national productivity"? (p. 8). As a broad economic generalization, this has validity, but it appears to be directed at management and union officials, since it speaks of "settlements." Here the generalization is irrelevant.

There are many things wrong with this statement.

It does not include fringe costs.

It assumes that the bargaining parties know the "sustainable rates of improvement in national productivity," so that they can be guided by it. But no one knows what are "sustainable rates"; furthermore, productivity improvement rates vary year by year, rising, according to BLS calculations, as much as several hundred percent from a low year to a high year within as few as 3 or 4 years. Next year or this year, productivity may not rise at all. Of what use, therefore, is a national average figure on productivity in wage bargaining?

If all managements and union officials agreed on a national average rate of productivity (assuming it could be known), wage adjustments would lose their essential allocative function; expanding establishments and industries, on the contrary, may have to bid above the national average, and shrinking ones should

bid lower, in order to reallocate work forces. Within an establishment widely varying wage and salary adjustments may be required to shift human resources.

If this is so, how can some "national average," even if it could be known—which it cannot—be of any use in wage "settlements"?

If such a national average, moreover, becomes a minimum in all cases but some union officials get more, as they will, the cost-push is thereby stimulated. Thus, by stressing this national average, the Economic Report is, probably unwittingly, feeding the fires of inflation.

The report states that this guide to wage settlements would allow increases without jeopardizing price stability. But then comes this surprising commendatory statement: "Indeed, such increases are the major means in our free economy by which labor shares in the fruits of industrial progress" (p. 8). Not only does this statement, unwittingly, lend validity to aggressive union official demands for increases, but it is doubtful that it is accurate. It would be easy to show that under a competitive economy, even though average wage rates were stationary, the productivity gains from new investment, technology, etc., would be effectively shared, in real terms, among workers as consumers. Surely no one would argue that savers and shareholders can gain from a competitive economy only as they receive steadily higher rates of interest or benefit only from steadily rising rates of profit.

MARKET POWER OF UNIONS AND UNION OFFICIALS

Perhaps the Economic Report was thought not to be the place to deal adequately with the economic impact of collectively bargaining, strikes, threats of strikes and the ever-present power (actual or latent) of force, coercion and violence in collective bargaining. The report urges moderation, but it does not engage the basic issue of excess union power; it urges more vigorous use of antitrust laws, including some new steps, in the product market, but ignores the problem of nationwide unions, union collusion and excess power of union officials. Yet, some 70–80 percent of the components of final or consumer product prices are labor costs. Thus, it does not make much sense to concentrate all efforts in the dispersal of market power in product markets, while the labor market power is provided with a short sermon on the use of "moderation."

Had the steel strike not been terminated on January 4, Congress would have promptly engaged the issue—and some say, this being an election year, might have passed some hasty legislation. The fact that the strike was not resumed does not in any way alter the conditions which led to the economic paralysis of the economy last year or the possibility of a repeat performance by the same or other unions. The strike settlement should have opened the way for a calm congressional investigation of the economics of our basic labor-management problems—especially the nature of the excess market power of union officials.

OTHER DEFICIENCIES

Although the report throughout is growth oriented, it also refers to other goals, such as freedom, competition, national security, individual security, stabilization, inflation control, and the like. There is inadequate analysis of the possibility that some of these goals may conflict with one another; nor is there any ordering of priorities. Furthermore, under the sheltering spokes of one or another of these multiple umbrellas—sound, steady growth, or competition, or national defense—it brackets miscellaneous and contradictory policies, often unrelated to the objective they are purported to further. The Economic Report should not be a potpourri of philosophical musings, welfare programs, political sociology, platitude, exhortation, and indoctrination. Its concept of human nature is excessively idealist.

The report on the whole demonstrates great faith in the power of public opinion, less faith in the power of example, and expresses inadequate awareness of the forces of competition and the free market and the power of freedom of entry in the goods and labor markets as powerful disciplinary forces. There are too many oughts and shoulds, not enough whats and hows.

SUMMARY

In spite of these critical remarks, the Economic Report contains much useful information and sound analysis and the latter outweighs the weaknesses.

It merits wider readership and study and we hope that any reservations herein expressed will be useful to your committee in developing its report and useful to the next Council of Economic Advisers.

Mr. SCHMIDT. I appreciate this opportunity, Mr. Chairman and members of the committee. I was asked particularly to discuss the President's Economic Report. As in the past, it is excellent in terms of statistical material and it is really a very valuable compendium of materials.

Unfortunately, in assessing the business outlook the steel strike has vitiated all the statistics throughout most of last year and even currently. So it puts a man like Mr. Ruttenberg in a very difficult position of seeing how 1960 would shape up.

I was sorry to hear Mr. Ruttenberg because he is very pessimistic about the last half of 1960. I would only say that if we have a properly functioning economy in terms of good political environment for consumers, investors, and savers, and the right kind of fiscal and monetary policy, it is always surprising where the elements of strength come from. These are never foreseeable.

While I agree with many of the things that Mr. Ruttenberg said about the buoyancy of the first half of 1960, we ought not to foreclose the possibility that the last half of 1960 will be even stronger than the first half.

The report of the President is growth oriented and this is a good thing. Everybody is for growth. Our only regret is that this concept of growth was not more carefully handled.

What do we really mean by growth? I notice that Mr. Khrushchev, for example, is boasting that the Russian per capita consumption of butter is now equal or in excess to ours. This is supposed to represent growth. On the contrary, it represents something contrary to growth.

In the 1890's we consumed about 22 pounds of butter per capita and now about 8, plus some margarine. But this decline represents a rise in our standard of living.

So I would suggest that we look much more carefully at this concept of growth and the figures on growth. It is just possible that the American people are getting about the rate of growth that they really want.

There is not any question that we could have a faster rate of growth if we were willing to pay the price. But growth has costs. It costs in terms of current consumption. If you want to have greater growth we must have more saving, more investment. It probably means, furthermore, that we may have to give up some leisure. But I regard leisure as a part of the proper conception of growth, although it does not enter into GNP.

So all this talk about our retarded rate of growth really lacks some very fundamental validity. Furthermore, growth is always disturbing. The report does refer to this. Growth means not just producing more of the same things. It means producing some new things. This means unemployment for workers. It means destruction of the value of investment in existing facilities such as the harnessmakers and blacksmiths of years ago and we must be ready to pay the price for this growth.

Furthermore, a great many people talk about social gains. But if you analyze this concept of social gains very frequently it is equated with doing less work: Longer vacations, more paid holidays, more paid vacations, more off-the-job benefits and so on.

So I think we are dreadfully confused on this growth issue. I think your committee could do a really analytical job of what we mean by growth.

Furthermore, what are the roadblocks to growth? In featherbedding, in the railroad industry we have an estimate which is based on a very careful calculation of over $500 million per year. We have a lot of it in many other industries and particularly in the printing industry, some phases of entertainment and construction.

This is not all the fault of labor. In many cases it is due to building codes as in construction, and in some cases management, I feel sure, is to blame. So if we are concerned with growth we ought to put much more emphasis on the roadblocks to growth and recognize that if we really make the market work—and this is really the test—it will cut through all the waste and will eliminate the roadblocks to growth.

This same thing applies with equal emphasis to the Government sector. The Economic Report sets forth an excellent criterion for the Government sector:

> The public use of funds, whether to continue established programs or to initiate new ones, must be justified on the ground that it makes a larger contribution to the well-being and economic strength than could be made by their private use. The entire range of Federal spending must be continuously on review, with this criterion in mind * * *.

The report which this committee issued 2 years ago through a Subcommittee on Fiscal Policy, a report entitled "Federal Expenditure Policies for Economic Growth and Stability," made exactly this same point.

We praised this report to the skies 2 years ago before your committee. Personally, I think it is one of the really great jobs that your committee has done and we would like to suggest perhaps after the congressional session is over, if you could ask your staff, a very able staff, to try to find criteria and techniques of measuring the public sector just as the private sector is always measured by the force of the marketplace.

One of your own members, Congressman Curtis, made an excellent speech on January 14 in which he pointed out that the private enterprise system in effect uses the marketplace as the equivalent of the scientist's laboratory. It is there in the marketplace that ideas, and by that he meant goods and services, are constantly tested, and they must be responsive to human well-being.

If you grant that a consumer-oriented economy is sound, then in a competitive economy the only way in which you could have these roadblocks to growth is by Government intervention, either in the private sector or in the governmental sector.

It is a very great challenge for this committee to follow through on your very excellent report of 2 years ago and see how you can get your staff to help you to set up testing techniques. There must be more techniques to test various Government programs to see whether they do in fact make a greater contribution than if the money had been left in the private hands.

We have made a little beginning in this direction by the user charges, the increase of which the President's Economic Report recommends. We moved a little in this direction through toll roads. But that system is now largely abandoned for the future. I think this would represent a very important forward step in bringing a

great deal more rational judgment into the committee hearings and the deliberations of the House and the Senate.

I have a few suggestions on congressional procedures. It is excellent that the Bureau of the Budget exists where the President is forced to bring together all his spending proposals and his revenue proposals. This acts as a discipline on the White House.

You don't have in the Congress a similar way of assessing total appropriations and total income. It would be excellent if you had a congressional center of financial management and if you had a single or possibly just two appropriation bills—one for the military and one for all the other—so that you gentlemen could look at the whole appropriations for a given year as a unit.

In that way only can you determine priorities. This is what every family has to do. It has to look at priorities in allocating limited income.

Obviously "backdoor spending" likewise ought to be eliminated.

Furthermore, at the end of the year we get all sorts of tabulations of what Congress has really done in the way of appropriating funds. We get confusing tables. It would be very helpful if we had some system that could be agreed upon by the accountants and by the Comptroller General, whoever the proper man is, to have an agreed upon record as to what Congress really has done, what the carry-overs are, what the obligations are, what the appropriations are, and so on.

A year ago we commended the announcement in the President's Economic Report of the plan to set up a Committee on Government Activities Affecting Prices and Costs which was to scrutinize the relevant National Government programs such as procurement, construction, stockpiling, price supports, and so on for their waste and inflationary potential.

It was disappointing that there is no reference in this year's Economic Report to the accomplishments of this Committee, if any. Here was a golden opportunity to do something specific.

I think everyone has agreed that our agricultural program is really a national scandal. If we had this kind of approach which a business man has to follow, a family man has to follow, I think we would set up a system of priorities so that we would have more funds for the really worthwhile governmental activities in our economy.

There are many other things that might be mentioned. I never understood why you continue to have three different minimum wage systems. You have the wage and hour law, you have the Walsh-Healey, you have the Davis-Bacon. Why have three separate agencies doing all these things? Why not a single agency? Why be victims of the past? These laws were adopted during the recession. They certainly ought to be integrated into our system as a minimum, or perhaps they even ought to be abolished because certainly economic expansion and high levels of employment do far more for the working man than any amount of Government wage fixing.

Take another case, the housing field. If you happen to be interested in looking at a couple of figures, see table at the bottom of the page. This table contrasts the nonfarm housing starts in 2 prosperous years in the mid-1920's and 2 prosperous years in the mid-1950's.

The figures show that 35 years ago without any Government intervention whatsoever we had over five new nonfarm housing starts per

million dollars of GNP as against only three housing starts in the mid-1950's. Housing starts in the mid-1920's per thousand population were moderately higher than in the mid-1950's.

Offhand, this unfavorable showing for the Government intervention period causes one to wonder whether all this congressional concern for housing was justified in the past 20 or 25 years and whether its continuation, particularly in the future, is wise or is necessary, and particularly in the face of the U.S. difficulties and the problem of determining governmental priorities.

I hasten to add that I don't mean to imply that these two sets of figures are conclusive. You certainly need more analysis than I have given here. But they are significant. They do suggest offhand that the perfectly fabulous amount of time that American businessmen in the construction field, the materials field, and so forth, Members of the House and Senate devote to congressional housing legislation year after year, may be wasted.

I think on the face of it there is no evidence that this is really necessary as a continuing process.

Take another case, depressed-area legislation. We are fearful that if this is adopted, even on a moderate basis, we will end up with some kind of a businessman-WPA program some years hence in virtually every congressional district, because you never stop with the initial standards. You all know that these things grow and grow and grow. It is a little disappointing to find that the President's Economic Report makes no reference at all to the problem of the investment climate and the job climate in terms of these depressed areas. Our conclusions are that these are very important factors in deterring industry to move in, and for existing industry to expand in certain areas.

I know this is a hot political issue and you don't want to talk about it very much, but I would like to emphasize that without this approach you may be overlooking a very important facet.

This brings us to the question of taxes. Considering the current inflationary pressures this is probably not the time for a major tax cut. But we need much new investment capital if we want more growth. We need more investment if we want better paying jobs. We need more investment per worker, more horsepower of mechanical energy per worker.

As the President's report points out, our labor force is going to grow about double the rate at the end of this decade as against the decade of the fifties. Even at the recent rate of around 825,000 growth in the labor force, and $15,000 per job, that calls for something in excess of $20 billion per year in new investment just to hold our own.

Representative CURTIS. How much was that?

Mr. SCHMIDT. $20 billion.

Representative CURTIS. Did you give the figure for individual job?

Mr. SCHMIDT. Yes; $15,000 per job.

Representative CURTIS. $15,000 of invested capital for each worker?

Mr. SCHMIDT. Yes.

Representative PATMAN. In comparison to what it is now?

Mr. SCHMIDT. It is approximately $15,000 now, as far as we can find out.

Representative PATMAN. I thought you were shooting for 15.

Mr. SCHMIDT. No. We are talking about $15,000 current investment per job. That is an average figure, not a marginal figure. You can, of course, always add additional people without much additional investment if you happen to be operating at less than capacity or if you want to work overtime or if you want to go to double shift. The figure is a little nebulous and a lot of work could be done on it. I think it indicates the kind of growth in venture capital and loan capital that we will need toward the latter half of this decade nearly double the average of the 1950's.

For this reason we were delighted that the Economic Report stressed the importance of continuing to review the tax system even though this year no tax reform of any consequence, or cut, is recommended.

We would suggest that this be taken rather seriously. If Mr. Ruttenberg is correct, you could, for example, in this session of Congress institute a tax reform and tax cut, but date it for January 1, 1961. That is only a rough suggestion.

Now on the interest rate ceiling, I think there is much loose talk. Here is an old 1918 law when interest on the Federal debt was partly tax exempt. Four and a quarter percent is wholly obsolete. I can't understand why any Members of Congress will reach back into our ancient past and try to justify the retention of this artificial ceiling.

We are supposed to be a free country. We are supposed to believe in the free market and the flexibility of the market. The market serves its function only when it is able to move. It is an anomaly to me that Congress will allow the Treasury to pay over 4¼ percent for short-term money and disallow the same on bonds. For the Congress to maintain this 4¼ percent ceiling on Government bonds must mean, and I can't see any other explanation, that Congress does not want the American citizen to buy Government bonds.

Instead Congress is driving the investor into other forms of investment. Why should Congress oppose our citizens buying bonds of the U.S. Treasury?

The CHAIRMAN. Mr. Schmidt would you be willing to have a question at this point?

Mr. SCHMIDT. Surely.

The CHAIRMAN. I think you misrepresented unintentionally, I am sure, the position of many of us on this point. Are you contending that the market for Government bonds is now a free competitive market, that the sale organization of the Government bond market is a free competitive bond market?

Mr. SCHMIDT. I think it is about as competitive as most markets.

The CHAIRMAN. You mean as competitive as the cement market or the shoe machinery market?

Mr. SCHMIDT. I don't happen to know how competitive those markets are but I think it is essentially competitive.

The CHAIRMAN. Did you read the report of the majority?

Mr. SCHMIDT. Which report?

The CHAIRMAN. The majority of this committee on growth employment and price levels.

Mr. SCHMIDT. Yes. I think you took the position there that you yourself opposed this ceiling but you wanted to tiein some other things and the committee minority accused you of "blackmail" in this connection.

The CHAIRMAN. If you read the report you would have seen that before the Treasury issues any appreciable amount of bonds it consults with representatives of the American Bankers Association, Investment Bankers Association, and in some cases certain other groups.

Mr. SCHMIDT. You know why that is.

The CHAIRMAN. Just a minute. We also find that in only 15 percent of the cases since 1953 has this advice been disregarded, whereas in 1937, in 1952 it was disregarded.

The question we raised was this: Suppose the Secretary of Labor were to set the basic rate of wages and were to do so after consultation with representatives of the AFL-CIO, and in 85 percent of the cases would agree with these representatives and in only 15 percent of the cases disagree. Would the U.S. Chamber of Commerce say this was a free, competitive setting of the basic rate of wages?

Mr. SCHMIDT. Do you think Secretary Mitchell does not consult the labor leaders on these matters in regard to Walsh-Healey and Davis-Bacon matters?

The CHAIRMAN. Does he fix the basic rate of wages?

Mr. SCHMIDT. He fixes the minimum. He almost fixes the exact rate in the case of Walsh-Healey and Davis-Bacon. I am sure he consults with the labor leaders.

Furthermore, the analogy is very bad and you know it.

The CHAIRMAN. I don't know it.

Mr. SCHMIDT. Why do they not consult Wall Street on the bill market. Because it is an auction market. The only reason they have to consult the moneylenders is because of the fixed coupon. They don't like to see a vast oversubscription and they don't like to see an undersubscription of Treasury securities. This is the only reason as far as I know.

The CHAIRMAN. The concrete recommendation which we made was to make the Government bond market more competitive, to require auctions for the sale and purchase of long-term securities so that the buyers could bid. The fact that these issues are oversubscribed nearly at least double, in some cases a little less, in many cases five or six times, is an indication that at the interest rates which are fixed, and the prices which are fixed at par, that the quantity demanded exceeds the supply.

This is the test which in a competitive market would indicate very clearly that the price was less than the competitive price. In a competitive market what would happen would be that the buyers would then bid against each other to get the relatively limited supply and the price would rise. But this is not permitted by the Treasury which instead requires the sale of the long-term secuirties at par. The suggestion which we made—not the suggestion, but the very strong recommendation we made—is to use the auction system for long-term securities as well as for bills.

I would think that you as the exponent of the competitive system would agree that what is sauce for the goose is sauce for the gander and you would come eagerly to our support in favoring the auction system. Perhaps you do.

Mr. SCHMIDT. I was just going to say you should not engage in mindreading too fast. I personally think what you are now saying makes a lot of sense, although I am not sufficiently expert in the field of the money market to be sure it is workable.

The CHAIRMAN. Would you present this to the U.S. Chamber of Commerce and urge them to recommend that the Treasury follow the auction system?

Mr. SCHMIDT. I am not sufficiently expert in the money market.

(Mr. Schmidt subsequently submitted the following for the record:)

CHAMBER OF COMMERCE OF THE UNITED STATES,
Washington, D.C., February 9, 1960.

Hon. PAUL H. DOUGLAS,
Chairman, Joint Economic Committee,
Congress of the United States,
Senate Office Building,
Washington, D.C.

DEAR MR. DOUGLAS: In the exchange of ideas during my testimony before the Joint Economic Committee you raised the question about the degree of competition in the market for Government securities. I should like, briefly, to analyze this issue further, and you may wish to include these remarks as part of the record.

The three questions which the majority report suggested lay at the core of the issue are: (1) the number of dealers in Government securities; (2) the consultation with the Treasury of representatives of the lender groups; and (3) the absence of auctions in marketing Governments other than Treasury bills.

(1) While there are 17 firms listed as Government security houses, there are no bars to entry. Other firms are free to enter if they choose, and in practice many of the larger banks around the country are prepared to buy or sell Government securities, at least in the short- and intermediate-maturity range.

The principal dealers carry an inventory of Government securities, but their main function is to serve as an intermediary between the ultimate buyers and sellers. Changes in the inventories of the Government bond houses, like any other shift in the supply and demand for securities, will have some influence over hour-to-hour conditions in the market, but like inventory shifts generally are self-limiting. These variations in dealer holdings, moreover, tend to facilitate trading in Government securities and make Treasury securities a more valuable instrument to hold for liquidity purposes and hence more readily marketable.

Given the volume of transactions that flows through the Government securities markets, and the shifts in public policy, economic conditions, and international transactions that necessarily have some influence on the level of interest rates, price changes appear to be in accord with the principles of competitive market principles.

(2) As I pointed out in my testimony, the need for consultation with the various lender groups arises most clearly in response to the way new Treasurys are priced. Since fixed coupon securities are sold at par in very large amounts it is incumbent upon the Treasury to know as fully as possible about available pools of funds seeking investment. The principals in this market, in the normal course of events, accumulate much relevant information about potential demand for Government securities. To ignore this valuable source of information would hardly seem sensible, particularly given the way in which new securities are priced and issued.

In point of fact, new Treasury securities in virtually all cases sell at prices only a fraction above, and more rarely below, the issue price. Occasionally, unforeseen changes in business condition or public policy will lead to unusual postissue price moves, but so long as the future is not perfectly predictable this is unavoidable. This price behavior indicates that the securities were sold with the proper coupon, and were issued at the closest possible price to the current market. Since your evidence indicates that the advice of the lender groups has been very frequently accepted, does this not imply that the Treasury was receiving accurate information about current market conditions?

(3) The question of auctioning Treasury certificates, notes, and bonds presents, as I noted in my testimony, some interesting and difficult questions about which it is difficult to make a strong statement. The Treasury bill market is very broadly based and widely used, and the auction technique is a valuable one in this connection. In respect to the longer term securities where the volume of trading is customarily smaller, the auction technique might yield an unusually wide range of bids and possibly higher interest costs than under the current arrangements. Reiterating my earlier suggestion, this question may be

one which the Joint Economic Committee might wish to study at some greater length.

I should like to register my agreement with the proposition in your report that the market for Government securities has become, if anything, a more efficient and, I should emphasize, competitive market during the postwar years. Therefore, imperfect competition in this market would not appear to be relevant in judging the issue of the 4¼-percent statutory interest ceiling on Government bond issues.

Yields on Government securities are closely related with interest rates and yields on corporate and State and local securities, mortgages, claims on various financial intermediaries, and also equities. It hardly seems possible, therefore, to control interest rates on Government securities unless all these other elements in the demand and supply for loanable funds were also controlled, which hardly seems to square with the freedom of choice which borrowers and lenders have in arranging their financial affairs.

In conclusion, this analysis deals with the questions that were raised during my testimony about competition in the Government securities market. It may serve some useful purpose if it were included in the record.

EMERSON P. SCHMIDT.

The CHAIRMAN. You deal with the money people who know these details. This is an excellent chance to apply competition to the purchase and sale of Government long-term securities.

Representative CURTIS. Will the gentleman yield?

The CHAIRMAN. Yes, I will be glad to yield.

Representative CURTIS. I think that Dr. Schmidt made a very good point, that a real study needs to be made. On theory it sounds very good. As the gentleman from Illinois knows, those who are expert in this pointed out many of the difficulties in going to auctions in these long terms.

I myself don't know enough about it, but I think the gentleman from Illinois would agree that we ought to look at this carefully and recognize some of the actual impediments to that system.

Does the gentleman recognize that there are impediments to this?

The CHAIRMAN. Not many, no. I would say study is frequently used by this administration as an excuse for inaction.

Representative CURTIS. Maybe you want to charge that.

The CHAIRMAN. I do charge it.

Representative CURTIS. That is your prerogative. I can say that hasty action also produces much damage.

Mr. SCHMIDT. If the chairman does not trust the administration, there is no reason why this committee could not get an objective study. This committee has produced objective studies. I would not say the last one was objective. Before you came back, Mr. Chairman, I praised your report of 2 years ago on "Federal Expenditure Policies for Economic Growth and Stability" in very exhaulted terms.

The CHAIRMAN. With thorough study I think you will praise this report with equal exultation.

Mr. SCHMIDT. I will not; I think this report is bad. As an economist, you know better. This is not a good report.

The CHAIRMAN. It is a great thing to have a free country. I am delighted that you are here and you can tell me this to my face. I would welcome an opportunity to go down to the chamber of commerce and tell them what I think on these matters.

Mr. SCHMIDT. We had you before our annual meeting some 4 or more years ago and there was not one word of your speech with which I disagreed. When you are at your best, Senator, you are really good.

The CHAIRMAN. I was never as good as I was on this report. I am prouder of this report than anything I ever did.

Representative PATMAN. Mr. Chairman, you brought up a question there I want to elaborate on briefly.

Mr. SCHMIDT. I don't want to take your colleague's time.

Representative PATMAN. This is important. The chairman said that in only 15 percent of the cases did the Treasury ignore the recommendations of the American Bankers Association and Investment Bankers.

Mr. SCHMIDT. That proves nothing.

Representative PATMAN. I will give them credit for this. When Mr. Humphrey wanted to raise the traditional interest rate from 2½ to 3¼ percent on that million dollars' worth of bonds in the early part of 1953, this committee recommended against it. Mr. Humphrey, notwithstanding that, went ahead and created the springboard for this spiral of interest rates commencing at that time by putting out three and a quarter bonds.

Mr. SCHMIDT. Your logic is simply false, Mr. Congressman. We have had a fabulous increase in the demand for credit in the past year. You know this to be the case. We had a third increase in the expansion of credit in 1959 over 1958. This is the fundamental explanation in the rise of the interest rate and not some shenanigans.

Representative PATMAN. I was talking about the period commencing in 1953.

Mr. SCHMIDT. Are you in favor, exclusively, of short-term debt?

Representative PATMAN. I give your members credit for being right with respect to that.

You represent the big fellows. Whatever they want you recommend.

Mr. SCHMIDT. You are simply wrong. I am sorry to say, because we do not get into these details.

Representative PATMAN. You always state you are for small business, but I do not see anything you do for small business.

Mr. SCHMIDT. I have heard you say that many times.

Representative KILBURN. Mr. Schmidt, can you answer that charge? He says you are for big business and not for small business.

Mr. SCHMIDT. I have answered him often before this committee and by my correspondence and statements I have introduced in the record—if he does not read, he will not understand, I do not know what more I can do.

Representative KILBURN. I do not, either. I agree with you.

Mr. SCHMIDT. 92 percent of our members are small businesses by virtue of the definition of the Department of Commerce.

Representative PATMAN. I am talking about the fellows who run the show. Small business does not have a chance.

Mr. SCHMIDT. You simply do not know what you are talking about.

Representative PATMAN. The big ones are head of the committees, they have seniority, they have expense accounts. They go to the meetings. The little man is working. He does not have anyone to step in his place to go to a convention. I have been watching it for 30 years.

Mr. SCHMIDT. I hate to say this about you. This is simply not true. Our policies are made by the organization members and not the Du Ponts and General Motors. They do not vote. Our policies are

made by our organizational members and no chamber, no matter how big or trade association, has more than 10 votes. No chamber has less than one vote. If the local people, the small retailer and grocer, are active and interested in the local chamber, that vote is recorded at the annual meeting. I do not know how often I have to say this and explain it. It is a waste of the committee's time.

Representative PATMAN. I want to ask one question.

Senator JAVITS. Mr. Chairman, may I be recognized?

The CHAIRMAN. I recognize the Senator from New York for 10 seconds.

Senator JAVITS. Mr. Chairman, I would hope very much that as a congressional committee we could observe the common rules of order. The witness is entitled to answer. The Congressman is entitled to ask questions. But it is simply impossible, and I think hardly proper, if the witness and the Congressman simply talk at each other.

Mr. SCHMIDT. I agree.

Representative PATMAN. I want to ask one question in conclusion. Over the years I have noticed things that are sponsored by small-business fellows who were opposed by big ones and vice versa. I would like for you to name me one time in the last 30 years when there is an issue before Congress involving helping small business and big business is on the other side—that you ever took the side of small business. Name one time that you ever took the side of small business when it was in conflict with the agitations of big business. Will you name that one time. If you do that, I will have to give you credit.

Mr. SCHMIDT. I have answered this precise question in a long letter to the committee in the hearings on the 1956 Economic Report of the President (pp. 521–522), and I don't think it is fair to take the time of the rest of the members of the committee.

Representative CURTIS. I wonder if we could have the record left open so all of the time could be listed. If it is in letter form, we could have the answer. I would like to see it.

The CHAIRMAN. Yes.

(The information referred to follows:)

CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA,
Washington 6, D.C., February 17, 1956.

Senator PAUL DOUGLAS,
Chairman, Joint Committee on the Economic Report,
United States Senate, Washington, D.C.

DEAR SENATOR DOUGLAS: Your statement at the hearings of the Joint Committee on February 15 that you think that I should have the privilege of submitting a written reply to the statements of the gentleman from Texas is greatly appreciated.

It does seem evident to us that he does not have a very clear conception of the nature of the chamber of commerce organization and movement and I hope that the following comment will help to clarify the matter.

While our work and activities go far beyond merely legislative matters, what I have to say will deal mostly with legislation.

Congressman Patman seemed to be under the impression that all of our policies are made at our headquarters here in Washington and that only a few individuals participate in such policymaking, and that the average small businessman has no voice or opportunity to participate.

Under our bylaws, the policy proposals may come from interested individuals, organization members, or national chamber committees and other sources. These proposals are generally thoroughly considered by one or more of our regular or special committees, of which we have more than 30. Maybe 700 or 800 business executives serve on these committees. Most of them have 1 or 2

academicians or professors or other professional people from outside the business sector, because we believe it is important to bring into our deliberations the experience and thinking of scholars and other individuals who are at least one step removed from the responsibilities of business management.

The policies are adopted either by annual meeting vote or by referendum of the organization members.

However, the individual businessman does not vote. The individual business or businessman exercises his voting rights at the local level with the local chamber or through his trade association.

However, no chamber of commerce and no trade association has more than 10 votes. This is a deliberate attempt on our part to be sure that the small organizations can be responsive in making policy. Our policies are sent to our organization members well in advance of the annual meeting and every chamber and every trade association is encouraged to make a thorough study of the policy proposals, many of which have of course originated with one or more individual chambers and, in that way, the delegates that do attend our annual meeting have a thorough opportunity to reflect local opinion of the main-street merchant, the shoemaker, the watch repairman and any and every business that is represented in the local chamber. Some 92 to 95 of all the businesses within the chamber movement are defined as small business under the definition of the Department of Commerce.

Furthermore, the national chamber maintains division offices in 6 major cities and district offices in another 17. Field staff men help local and State chambers of commerce and trade associations to arrange and conduct area and regional meetings devoted to national issues and problems. We, ourselves, from national headquarters are constantly organizing meetings on key problems throughout the country. At these meetings, the local businessmen have an opportunity to talk over important current national issues, to ask questions, to explore all sides of the issues and to make suggestions. In the past year, the national chamber sponsored about 3,000 of these local meetings and this type of work is continuing.

We developed a considerable number of leaflets, pamphlets and other tools to help the local chamber in the local industrial and other development work. These tools are concerned with virtually every phase of human welfare at the community level. These tools are the result of much field work, much contact with local problems, and local individuals and are designed to be of maximum usefulness, particularly to the little businessman and the small chamber of commerce and trade association.

Most of the members of our board of directors have come up through the local chamber of commerce, having served on committees, on the board of directors and frequently as president of the local chamber. Most of them are initially contacted and suggested for membership on our board of directors by local chambers. Furthermore, it is the local chambers and trade associations that place their names in nomination and vote on them again. The big corporations do not, as such, vote directly, although they may, of course, like any other member of a local chamber, make suggestions and exercise their membership privileges.

The United States Chamber of Commerce represents all sectors of our economy, including manufacturing, distribution, transportation, public utilities, insurance, finance, agriculture, natural resources, and others. Because of this broad interest base, our policies have to be acceptable not to any narrow sector of the business, but rather to all sectors and, for that reason, we feel that by and large our policies are geared to promote the national welfare and not any particularistic sectional or sector welfare.

Yours sincerely,

EMERSON P. SCHMIDT,
Director, Economic Research Department.

The CHAIRMAN. Mr. Schmidt, this is not unfamiliar to you, these rough-and-tumble discussions. We have a very high opinion of you personally.

Representative PATMAN. I apologize for taking so much time, Mr. Chairman.

The CHAIRMAN. I don't think you took as much time as I did, as a matter of fact.

Representative CURTIS. I don't think he has finished his statement.

Mr. SCHMIDT. There is another problem that I think this committee could help to eliminate, Mr. Chairman. There is the most profound confusion in this country on the availability of loan funds versus the money supply. Somehow people equate the availability of loan funds with the availability of money. This is wrong.

David Hume, as I am sure the chairman knows, 200 years ago made the point that if you doubled the money supply overnight it would not reduce the interest rate. There seems to be an assumption that by multiplying the money supply, getting rid of so-called tight money, that you thereby lower interest rates.

This is fundamentally fallacious. David Hume 200 years ago saw this. If everybody's cash liquidity suddenly doubled, in business and individually, housewives and everybody, we would go right out and spend the money, we would bid up prices and the relation of the supply of money to the GNP would be exactly the same or probably be about the same, some weeks, some months after. The interest rate is, after all, a real phenomenon. It is not a monetary phenomenon. It goes back to time preference. It goes back to the indisposition to save. It goes back to the fact that in order to encourage saving you must put a premium on saving. So the interest rate is much more fundamental than money. You would have an interest rate if you had no money system at all, a purely barter system.

The CHAIRMAN. Would you object if I call certain facts to your attention?

Mr. SCHMIDT. I would be very glad to hear you.

The CHAIRMAN. With Hume and these other men, you have just now assumed that you are holding production constant and increasing the supply of money. I grant of course under these conditions the price level will rise. But we have not been dealing with that situation, and in the last few years that has not been the case.

What we have is an economy that grows at differing rates through time. But the facts are that since 1953 it has grown at the rate of 2.3 percent a year. We think that rate of growth is too slow. That is not here nor there. But the money supply in the sense of the demand deposits plus currency was increased by only 1.8 percent a year.

It is my belief, and I think a common belief, and I believe in the quantity theory of money, that the supply of money should be increased at approximately the rate of the increase in the real national product, and that a failure to do so means that you will either have a decrease in the price level or strains will be put upon certain sections of the economy which will actually slow down production and retard growth.

That is the issue. I have been distressed at the inability of many people to understand what the issue is and to ascribe to us who think that the Federal Reserve has unduly restrained credit, I have been distressed that they say we are inflationists.

We are antideflationists. My goal is a stable price level with the money supply increasing at approximately this rate. I think on this point the Federal Reserve has tended to adopt the reasoning which you have just advanced and to regard any increase in the money supply as being somehow inflationary.

Mr. SCHMIDT. You are wrong. I happen to agree with what you said in the last 2 minutes. I think that is a very good analysis. There is nothing in my statement or in anything I have written and I have written a fair number of pamphlets and articles that disagree with what you have just said. I think if you want a stable price level you have to have what you said, roughly 3 percent, some people think 5 percent increase in the money supply per year.

The CHAIRMAN. That is the whole issue.

Mr. SCHMIDT. No; it is not.

The CHAIRMAN. That is the whole issue.

Mr. SCHMIDT. No.

The CHAIRMAN. At least it is the issue so far as our basic criticism of the past policy of the reserve is concerned. They did not expand the money supply in accordance with the actual increase in production and with other policies we could have had a greater increase in production and have absorbed a still greater increase in money supply without inflation.

It is as simple as that.

Mr. SCHMIDT. This is a very close decision, Senator, as you know, as to what the Federal Reserve policy ought to be. Furthermore, I don't think you are quite—I should not say inaccurate because I don't really know—when you talk about the money supply, currency and demand deposits. We have a new liquidity situation. We have financial intermediaries in a volume that we didn't have 20 or 30 years ago which create much near-money. So we are not so sure that the proper measure of the increase in the money supply is the currency and the demand deposits of commercial banks.

When you have a rule which says you can't pay any interest on demand deposits but you can pay a little interest on time deposits, you can pay still more on savings deposits, I think you have to look at the matter of the money supply in a broader sense, Senator.

For that reason I would be much more hesitant to be critical of the Fed. I certainly would agree that if the Fed had a looser fiscal policy we would have more growth.

The CHAIRMAN. We would have had more growth.

Mr. SCHMIDT. We would have had more shortrun growth. But we also would have had more inflation. The people who denounce the Fed will be the first to denounce the rise in prices. If the Fed had been "less leaning against the inflation wind," we would certainly have had higher prices.

I don't think you can deny this. So I don't think this is a very easy decision for them to make. I think if you went around this country and the rest of the knowledgeable world you would find that it is the judgment of thinking people that the Federal Reserve here in Washington has the best research staff of any part of the U.S. Government. I don't believe they are dedicated to Wall Street.

I happen to know some of those people. They are my former colleagues. I think they are just as concerned with economic growth and the health of our economy as you or I. I would certainly not put my motivation at a higher level than I would theirs. I think we ought to be a little more slow in prejudging them. This is the thing I object to in your majority report that you issued about a week ago. I think it is dogmatic. It is based on a staff report which was gotten together in a terrible hurry, to the point where the typographical errors them-

selves are so numerous that I cannot read parts of it. If typographical errors are so numerous, I wonder about the statistics and so on. Even names are misspelled. We all make errors but this is really bad.

Incidentally, if you are going to reprint the staff report I hope you will really take a fine tooth comb and go over it line by line to get the typographical errors out. There are parts of sentences stuck in the middle. I don't know if you have noticed this. If the rest of the staff report is as carelessly done as the proofing was, and I hope it wasn't—I don't mean to imply that it was—but if it was as carelessly done as the proofing, I think it deserves a real red flag.

I am afraid I am taking too much time.

The CHAIRMAN. I recognize that I have contributed to the length of this discussion. Mr. Robey of NAM is here. We want to give him a full chance to develop his paper.

Mr. SCHMIDT. I am willing to stop at this point.

The CHAIRMAN. You and I together have consumed 45 minutes. I wonder if you could conclude briefly.

Mr. SCHMIDT. I have only two main additional points. One of the things I liked in your majority report on the study of employment, growth, and price levels, is that you did acknowledge that the balance of payments problem has some bearing on our future domestic stabilization problem. This was not recognized in the President's Economic Report and I think that is a serious deficiency in his report.

The other thing I wanted to mention begins on page 17 and 18 of my statement. This is pretty serious. I don't know whether to take the time to go through with it or not. If you don't want me to, I will stop at this point.

The CHAIRMAN. I will say if there is criticism of our report, we, of course, want you to give it. If there is praise, that can be passed over.

Mr. SCHMIDT. It happens to be criticism.

The CHAIRMAN. Very good, go ahead.

Mr. SCHMIDT. Very bad, I would say.

The CHAIRMAN. No, we want to give you a chance.

Mr. SCHMIDT. On the top of page 17:

> Of what use to management or union officials is the statement that wage settlements "* * * should not be such as to cause the national average of wage rate increases to exceed sustainable rates of improvement in national productivity"? As a broad economic generalization, this has validity, but it appears to be directed at management and union officials, since it speaks of "settlements."

But here this generalization is completely irrelevant. Furthermore, it doesn't include fringe benefits.

The CHAIRMAN. May I correct a misapprehension. I thought you were criticising our report, not the President's. So what I was saying is that we would welcome criticism on your part of us.

Mr. SCHMIDT. Your report is not really before me today.

The CHAIRMAN. I understand. The discussion has been so interlaced that I thought you were discussing our report.

Let me say that we are just as anxious to hear praise for the President's report as criticism.

Mr. SCHMIDT. I think overwhelmingly it is a good report but there are some serious defects. The last two pages of my testimony go to a very fundamental point on this problem of productivity and wage

settlements; I think very few people understand it and it is very misleading.

So I will stop at that point.

Senator JAVITS. Mr. Chairman, may we hear the point that the witness is trying to make?

Mr. SCHMIDT. I can probably save time by reading a couple more paragraphs. This statement assumes that the bargaining parties to a wage settlement, say in the steel industry, know the sustainable rates of national productivity so that they can be guided by them.

But no one knows what are "sustainable rates." Furthermore, productivity gains vary from year to year, rising according to BLS statistics, as much as several hundred percent in a low year to a high year within as few as 3 or 4 years. Next year or this year, productivity may not rise at all. Of what use, therefore, is a national average figure on productivity in wage bargaining?

If all managements and union officials agreed on a national average rate of productivity—assuming it could be known, wage adjustments would lose their essential allocative function; expanding establishments and industries, on the contrary, may have to bid above the national average, and shrinking ones should bid lower, in order to reallocate work forces. Within an establishment widely varying wage and salary adjustments may be required to attract or shift human resources.

If this is so, how can some "national average," even if it could be known—which it cannot—be of any use in wage "settlements"?

If such a national average, moreover, becomes a minimum in all cases but some union officials get more, as they will, the cost push is thereby stimulated. Thus, by stressing this national average, the Economic Report is, probably unwittingly, feeding the fires of inflation.

The report states that this guide to wage settlements would allow increases without jeopardizing price stability. But then comes this surprising commendatory statement:

> Indeed, such increases are the major means in our free economy by which labor shares in the fruits of industrial progress.

Not only does this statement, unwittingly, lend validity to aggressive union official demands for increases, but it is doubtful that it is accurate. It would be easy to show that under a competitive economy, even though average wage rates were stationary, the productivity gains from new investment, technology, etc., would be effectively shared, in real terms, among workers as consumers. Surely no one would argue that savers and shareholders can gain from a competitive economy only as they receive steadily higher rates of interest or benefit only from steadily rising rates of profit.

In the next part, of my paper the problem of undue market power of unions is discussed and we were disappointed that the Economic Report was completely silent on what to do about this.

The CHAIRMAN. Thank you. I think I should apologize to my colleagues for taking up so much time. With the next witness I will be quiet so they can examine.

Mr. Robey, we are glad to have you.

STATEMENT OF RALPH ROBEY, ECONOMIC ADVISER, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. ROBEY. Thank you. I have a statement here which I will read.

The CHAIRMAN. Very well.

Mr. ROBEY. The very optimistic Economic Report of the President, submitted to Congress on January 20, 1960, presents a picture of the golden era which lies within the grasp of the American people. The description of our future opportunities plus a recapitulation of the tangible and intangible gains already achieved by our economic system should serve to remind our population of the extent of our own well-being. The progress already achieved and the prospects for the future decade as outlined by the President should produce some sober reflections by those who criticize the good fortune of the American people and question the soundness and capabilities of our economic system.

The success of the American economy in providing the highest living standards for its citizens in addition to rendering enormous amounts of aid, both economic and military, to its allies is no mere accident or turn of fortune. This unique ability stems from our free enterprise system with its free institutions. While the planned economies with their rigidly scheduled production and growth rates subject their populace to low living standards and political oppression, the free enterprise system of the United States has advanced to new heights in living conditions, while still providing and guaranteeing the basic element necessary for man's development and advancement—individual freedom of choice. Indeed it is the guarantee of freedom and reward for individual initiative which alone can provide the impetus to our economic advancement.

For reiterating and documenting these facts concerning our well-being we should be indebted to the President. I am in complete agreement with his prediction of the future improvements which our economy is capable of attaining. Concerning suggested measures and policies to be followed in achieving the goals he has outlined, I have some very definite reservations. While the Economic Report expresses the fond hope that the economy will act in the way necessary for the attainment of the goals outlined, I feel that certain constructive steps are necessary for the fulfillment of our aims. In the comments which follow, I will review the areas where recommendations for constructive action are not contained in the Economic Report, but where such action is positively needed. I will also indicate my reasons for believing that certain actions suggested by the President are not desirable.

Responsibility for economic growth

The Economic Report presents an analysis of the role, and hence the responsibility, of the Government, private associations, and individuals in meeting the challenges of the next decade while maintaining a rate of stable economic growth. The acceptance of these responsibilities by each of the three groups is a prerequisite for the creation of a proper economic climate needed to attain our economic goals. As in any other duty involving social responsibilities there is the inherent need for both positive action and restraint.

The Government, an instrument created by, and responsible to, its citizens, has the duty to adopt and enforce legislation and policies which promote and protect the efforts of its citizens to improve the economic well-being in a climate of freedom. This committee is well aware of the obligations which the executive and legislative branches of our Government have in these matters. I would like to read before this committee three statements from the current Economic Report, the principles of which should be incorporated in the framework of any governmental policy affecting our economic life.

> Indeed, excessive reliance on governmental machinery may not only frustrate the quest for steady economic growth and reasonably stable prices, but may also have undesirable consequences for our economic system and our freedoms. [1]
>
> Open markets perform the essential task of channeling economic resources into the uses that businessmen and consumers deem most satisfactory; in this way, they contribute to the productiveness of our economy and to the quality of our living. They should remain free of unwarranted restraints. [2]
>
> The use of public funds, whether to continue established programs or to initiate new ones, must be justified on the ground that it makes a larger contribution to well-being and economic strength than could be made by their private use. * * * It must always be borne in mind, however, that we grow only by investing more and producing more, not simply by spending more.[3]

It is my conviction that the economic goals outlined in the Economic Report will not be attained unless the people entrusted to govern keep these principles constantly in mind.

Unfortunately, the remainder of the report does not always apply these principles. An example is its failure to recommend a prompt correction of the incentive-destroying and capital-restricting features of our income tax rate structure. The whole area of taxation receives only a few brief comments in this report, although in my opinion, there are compelling reasons for enacting economically sound tax reform legislation at this time.

For years the American economy has been subjected to a tax rate structure which impedes investment and growth. Efforts to correct this situation have been frustrated by the sequence of deficits and near balances in the Federal budget. This tax burden has been further intensified by the heavy increase in tax collections on the part of State and local governments. Now, when a substantial surplus in Federal fiscal operations is finally in sight, the Economic Report intentionally ignores and omits any discussion of tax reduction. Apparently this omission was intentional for the recent budget message emphatically stated that tax reduction is not planned for this year. It is inconceivable to me how the Federal Government can fail to seize upon the very earliest opportunity of relieving its people of a very serious deterrent to economic health and growth.

The Economic Report goes into great statistical detail to outline the goals which we should attain in the next decade. It also points out that an enormous amount of investment will be necessary if these goals are to be attained. The necessary conditions for the creation of investment capital are the opportunity to save out of current production and the incentive of making and retaining the earnings from investments. The present tax rate structure substantially chokes off these prerequisites for the creation of investment capital.

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1 Economic Report of the President, January 1960, p. 4.
2 Economic Report of the President, January 1960, p. 5.
3 Economic Report of the President, January 1960, p. 6.

Even if a surplus were not projected, I would urge on you the desirability of immediate and effective tax rate reform. Tax reform would not only provide the capital needed for investment, but the psychological effect of such a step would help to create the proper economic climate in which our quest for economic advancement must operate. Government revenues depend on economic conditions, as well as on tax rates, and the net effect of tax rate reform would be to increase, rather than reduce, revenues.

As this committee knows from my past testimony on the Economic Report, the National Association of Manufacturers endorses the bipartisan Herlong-Baker bills. The enactment of the procedure laid down in these bills will produce an orderly and gradual reduction in the tax rate structure. Specifically this procedure would gradually reduce the present tax rate by more than 50 percent in the middle-income brackets, and cut the top rate from 91 percent down to 47 percent. The basic tax rate would be reduced from 20 to 15 percent. There would be corresponding reductions for the rates in between. Simultaneously corporate rates would be reduced from 52 percent down to 47 percent.

Spread over a period of 5 years (with provisions for a delay of 1 year for each scheduled reduction, at the option of Congress) the provisions in this bill will in no way endanger the fiscal stability of the Government. On the contrary, enactment of the Herlong-Baker bills will increase the revenue of the Government as a result of the stepped-up economic activity. In the private sector it will rekindle the driving force which is the foundation of the private enterprise system—the right to save for investment and the right to earn and keep the rewards of enterprise.

Responsibilities of the private sector

The current Economic Report repeats a plea made in the 1959 Economic Report addressed to business and labor leaders. This request asks these two groups to work together in a common interest to expedite the most economic use of our resources of manpower and material. Specifically the report calls for true and honest collective bargaining to hold labor payments within the range justified by productivity records and to cooperate in fostering higher productivity.

This approach fails to give adequate recognition to the true conditions existing in collective bargaining procedures today. Valid collective bargaining demands that both sides have roughly equal bargaining power. Indeed, the word bargain implies give-and-take procedures in negotiating sessions. with neither side able to overwhelm the other by its preponderance of power. No such equality exists in today's labor negotiations because union leaders possess monopolistic power in pressing for increased wage demands, fringe benefits, and restrictive work practice rules. The power that is lodged in the hands of the men who run the country's labor unions today far exceeds the power possessed by certain industry groups in the last century which brought about the enactment of our antitrust laws. This monopolistic power of unions was readily evident in the recent steel strike.

During the past session of Congress, the American public expressed its feelings regarding the extent to which corrupt labor leaders have gone to rob and terrorirze their members, business and the general

public. The end result of this public outcry was the enactment of the Labor-Management Reporting and Disclosure Act of 1959. While this law made great strides in the correction of abuses connected with the internal operation of unions, its provisions do not correct the equally dangerous monopolistic powers now held by union leaders in their collective bargaining negotiations.

While the Economic Report of 1959 described the economic dangers arising from abuses of "the great power lodged in the hands of labor union leaders,"[4] the current report does not repeat this warning. Over the past year these monopolistic powers have not vanished or even diminished. Indeed, they have been intensified and expanded.

Unless legislation to dissolve or control this monopoly power which labor leaders adroitly manipulate to force their demands on industry and the public is forthcoming, the wishful plea for labor-management cooperation at the bargaining table has no chance of becoming a reality. True and productive collective bargaining can take place only when both sides possess a degree of equality which permits honest give-and-take negotiating in the settlement of labor disputes, which are economically sound and in the best interest of all parties concerned, including the consuming public.

In suggesting general principles to be followed as guides in arriving at noninflationary labor settlements, the current Economic Report recommends that: "Settlements should not be such as to cause the national average of wage rate increases to exceed sustainable rates of improvement in national productivity."[5] hat is a widely held view. However, I should also point out that it is not of much value as a criterion for collective bargaining. No one bargains "the national average of wage rate increases." This average is the unforeseen product of numerous individual settlements which, as the above-quoted statement implicitly recognizes, can not be bound to any statistical criterion. We may expect the two averages—the national average of wage rate increases and the national average of productivity—to coincide if, and only if, neither side of the collective bargaining table possesses overwhelming power to enforce its demands.

The President's report also expresses the belief that: "* * * price reductions warranted by especially rapid productivity gains must be a normal and frequent feature of our economy."[6] he fact is, of course, that despite the prevailing upward trend in prices generally, there are many instances of price reductions occurring all the time. I would hope, however, that this remark by the President will not be seized upon as a justification for making nice statistical comparisons of productivity and then pointing the finger at specific industries which, in someone's opinion, ought to reduce prices. Our competitive markets do not operate in this mechanical way. Productivity is only one of the numerous factors which influence price. As long as competitive conditions prevail, there is no reason for substituting any statistical standard for market determination of price.

Although I cannot fully accept the solutions suggested in the Economic Report for the settlement of labor disputes, I do commend its calling attention to the serious need for a broader public understand-

[4] Economic Report of the President, January 1959, p. 5.
[5] Economic Report of the President, January 1960, p. 8.
[6] Economic Report of the President, January 1960, p. 8.

ing of the problem. In addition, I emphatically endorse the following statement.

It would be a grave mistake to believe that we can successfully substitute legislation or controls for such understanding.[7]

Heart of the Government's program

I would like to comment briefly on the three elements of the administration's program for the coming year, the acceptance of which the President deems necessary for the maintenance of fiscal soundness. They are—

1. Enactment of the budget which was recently submitted to Congress.
2. Use of the expected $4.2 billion surplus for reduction of the national debt.
3. Lifting the current statutory maximum interest rate of 4¼ percent on Federal securities with a maturity of over 5 years.

Generally I understand and approve the long-run objectives of these three requests. However, there are some questions to be raised in regard to their implementation. As far as the President's budget is concerned, every effort should be made to find room for reduction in the proposed gigantic expenditure of $79.8 billion, which represents an increase of $1.4 billion over the current year's outlay. The fact that revenues are expected to increase to a point where a surplus is indicated is no license for Congress to assume that the necessity for further economies in the operation of government has lessened. A year ago there was an eruption of grassroots feelings on the subject of excessive governmental expenditures. Burdened with the same heavy taxload, this feeling on the part of the public is likely to erupt again.

I would also like to remind the committee of the continuously increasing proportion of Federal expenditures which are annually voted to carry out commitments made in previous sessions of Congress. The permanent nature which such expenditures have assumed is diminishing the power of Congress to exercise control over expenditures. In evaluating each piece of legislation, it is imperative that the total cost of each program carried through to its completion be detailed and understood. In the last session of Congress, a veterans' bill was passed, the total cost of which has never been estimated and is impossible to estimate. Without considering the merits of this bill, it is disturbing that no one has any idea what future expenditures this legislation will entail. This type of legislative action should be avoided and all proposed legislation wherever possible should have an estimate of the total cost of the program involved.

The President recommends that the expected $4.2 billion surplus be applied to a reduction in the national debt. With the debt presently standing at $290 billion, and involving an annual interest service charge of $9.6 billion, debt reduction is a sound long-range objective. I do not believe, however, that the immediate need for tax rate reform should be sacrificed in favor of maintaining a substantial surplus in the budget for fiscal 1961. In the long run, we shall be able to reduce the national debt substantially only if we have a flourishing and growing economy. For that purpose tax rate reform is essential and the sooner we enact it the better our chances for sustained long-term debt reduction will be.

[7] Economic Report of the President, January 1960, p. 8.

The proposal of the President for lifting the present interest rate ceiling of 4¼ percent on long-term securities has been widely debated. Unfortunately, the heat generated in these debates has failed to throw much light on the merits of this proposal. Enlightenment is forthcoming, however, in the sound economic arguments presented in the Economic Report for the adoption of this proposal. Too much of the Federal debt is in short-term maturities, almost three-quarters of the marketable securities mature within 5 years or less. The increasing amount of refinancing in short-term bills complicates the problem involved in debt management, has pushed up short-term rates to a level above those in the long-term market and it is inflationary. Since the Government must compete with other borrowers in the capital market, it must be able to meet the long-term interest rates established in the open market. In the interest of sound debt management which influences all facets of our economic life, both domestic and international, I agree that the statutory interest rate limit of 4¼ percent should be lifted. Such a step is necessary to correct deteriorating conditions in the debt management program and to reaffirm the strength of the dollar in the international market.

U.S. international position

The year 1959 found U.S. payments in international transactions exceeding receipts by a widening margin. With a deficit in these balances of $4 billion in 1959, the gap is expected to narrow somewhat to about $3 billion in 1960. Nevertheless, this situation requires corrective action, for any possibility that these conditions will continue indefinitely poses a serious threat to the domestic and international well-being of the United States.

The Economic Report analyzes the numerous contributing causes of our present deficit position. Some of the causes reflect an improved economic status in other industrial nations, which I am happy to see, but other causes reflect a deterioration in the economic position of the United States. These latter conditions must be corrected immediately if we are to guarantee our domestic stability and growth and if we are to protect the recently acquired economic stability of our allies whose economic livelihood is interwoven with our own. Domestic policies aimed at stabilizing prices, eliminating inflation and fostering economic growth are the essential prerequisites for the correction of our present deficit position.

My major cause for concern in this area is the possible development at some time in the fairly near future of a conflict between our domestic objective of maintaining high levels of employment and production and our international objective of preserving world confidence in the dollar. Rising cost levels tend to restrict markets for our output at home, as well as abroad. In the recent past, this had led to periodic downturns in the level of business. One of our chief weapons for dealing with these situations has been a "lean against the wind" monetary and credit policy. In other words, during recessions we have reduced interest rates and made money and credit easier to obtain in other ways.

With our balance of payments showing a marked deficit, and with foreigners holding large short-term balances in this country, it would be extremely dangerous to resort to an inflation-promoting money and

credit policy at any time in the near future. If interest rates were reduced, foreigners might withdraw their balances and even provoke a "run on the dollar." In January 1960, the Bank of England raised its interest rates from 4 to 5 percent to prevent the danger of capital funds flowing out of the country and to attract outside capital. This move does not reflect any immediate emergency in England, but rather farsighted planning by the Bank of England to meet the competition in the international monetary market. We can escape from our dilemma only by reducing the pressure, arising out of our labor monopoly, which would tend to create a continuous rise in cost levels.

Finally, I heartily recommend the continuance and redoubling of the efforts now being made by the U.S. Government to persuade other industrial nations to remove the restrictions they have placed on imports from the dollar area.

The legislative program for 1960

Time precludes a detailed discussion of the legislative program outlined in the current Economic Report. I must, however, briefly comment on some of the proposals for legislative action which have been submitted.

The legislative recommendations offered "to strengthen economic competition" will only produce the opposite effect. Premerger notification laws, if enacted, will create serious financial losses to the parties concerned and will impede the process of allocating the productive resources of the Nation to those who can use them most efficiently. Granting the Attorney General the power to seize the records of companies when civil procedures are contemplated in antitrust cases can only weaken competition as the advantages which enable the firms involved to compete are exposed to other companies in the same business.

The recommendation that States increase unemployment benefits to make these payments equal to at least half of the unemployed person's regular earnings would, in my opinion, prolong unemployment. When one considers that the basic tax rate is 20 percent and there are normal expenditures connected with any job, the prospect of remaining unemployed and receiving a tax-free sum equal to half of normal earnings would impair the incentive to seek out and accept employment. The only effective way to correct unemployment is through the creation of an investment and business climate which could provide more job opportunities.

I also object to the recommendations already made to Congress, and endorsed in the Economic Report, on the administration's area assistance program. They are not only incapable of solving the existing problems, but they contain provisions which would deter economic growth. Subsidizing economic activity in these areas merely prolongs a serious problem; it does not correct it. The correction of the problem can best be effected by local authorities and voluntary organizations who understand the nature of the problem—not by Federal subsidy. The availability of a Federal loan will seldom, if ever, be a decisive factor in the location of new and desirable industries. In addition, direct business loans by the Federal Government violate the declared national policy of fostering and promoting free competitive enterprise.

A look to the future

I believe that the high level goals of economic well-being foreseen in the Economic Report are well within our reach provided we adhere to the policies and principles which will foster our free market economy. The future offers both challenges and opportunities which the American economic system is fully capable of meeting and utilizing to its advantage.

Probably there will be periods of recession in the next decade as there were in the past 10 years and throughout our history. The increasing vigor and ability with which we have been able to recover from these recessive periods attests to the soundness and durability of our system. It is in the private sector of the economy, which employs 89 percent of the labor force and produces 90 percent of all goods and services, that this virile recuperative power lies. I seriously question the soundness of relying upon the so-called cushioning measures employed by the Federal Government when one realizes that the Government ran up a $12.6 billion deficit in its attempts to ease the effects of the recent recession. The inflationary effects and debt management problems resulting from the deficit will be with us for a long time to come.

Any pause or temporary setback in economic progress we may experience in the future certainly will provide greater challenges to our ability to adjust policies to meet these challenges without scuttling the underlying tenets of the free market system. One such challenge which immediately comes to mind is how much fortitude will be forthcoming when a temporary reversal in our growth trend brings forth outcries for an easy money policy. As the stability of the U.S. dollar is being seriously threatened in the world market, the necessity to resist an inflationary money policy takes on an added urgency.

Such challenges can, and will, be successfully met as we have met other challenges in the past by adhering to sound economic principles. The present well-being of the American people, so excellently depicted in the Economic Report, attests to the ability of the free market system to provide the most benefits, both tangible and intangible, to the most people in a climate of economic and political freedom.

The CHAIRMAN. Mr. Curtis, do you have any questions?

Representative CURTIS. I just wanted to ask this question. This expansion that we foresee in 1960 is based to a considerable degree on the proposed spending on the part of industry for capital expansion. I presume that the manufacturing sector, which you represent the bulk of, is part of this expansion.

Mr. ROBEY. Definitely.

Representative CURTIS. Do you see any danger to that expansion from tight investment money?

Mr. ROBEY. Congressman, high money rates, of course, tend to hold down the volume of investment. But bear in mind when a business borrows funds, if it is other than a very small business, it gets to deduct the interest rate as a business expense, and that tax rate is 52 percent, so actually the rate of interest is not as important as it might appear on the surface.

Representative CURTIS. So you don't believe that would be an interfering feature?

Mr. ROBEY. It would eliminate certain marginal elements, of course, but that is the purpose of it.

Representative CURTIS. Is there any prospect that any of this expansion might be financed by more equity capital?

Mr. ROBEY. We would hope so. Of course, we have a very high stock market. It is easier to sell bonds than it is to sell equities at the moment.

Representative CURTIS. That is right. Also, the tax structure is such that it favors debt.

Mr. ROBEY. Yes, sir.

Representative CURTIS. One other comment. One of the things that has been of concern to me is the decline in employment in the manufacturing sector. It is primarily a decline, it seems in the blue collar sector, while there has been an increased employment in what we call the white collar sector. This would indicate that is the result of productive gains. Would you say that is so?

Mr. ROBEY. No, not necessarily. I think it indicates the changing character of our production and the necessity for more skilled workers.

Representative CURTIS. Of course, in one sense a white collar employee tends to be an annual employee.

Mr. ROBEY. That is right.

Representative CURTIS. Your wage employees are the others.

Mr. ROBEY. Hourly employees.

Representative CURTIS. So the net result should be more stability of employment in the manufacturing sector?

Mr. ROBEY. I guess it would have that tendency but how important it would be, I don't know. I have seen no appraisal of that. You can fire a white collar worker just as well as a blue collar worker.

Representative CURTIS. That is true.

Mr. ROBEY. By and large I think probably the turnover is a little bit less. But I don't know how much the difference is.

Representative CURTIS. There is one other comment. I have posed this as an axiom simply because I have not seen any studies. But it looks like the more rapid the technological growth in an industry the more frictional unemployment is created. For those who seek this more rapid growth I have suggested that they should be ready to pay the cost in increased frictional unemployment. Would that be a fair observation?

Mr. ROBEY. I would want to see your proposal in detail before I attempt to appraise it, Mr. Curtis, because it might be a good idea. It might also be a ruinous thing for some companies.

Representative CURTIS. I was just commenting on the phenomenon. I am not urging that anything be done. I am wondering if the phenomenon is true?

Mr. ROBEY. One thing we definitely do not want to do is to slow down the technological improvement.

Representative CURTIS. I certainly agree with that. On the other hand, those who want the growth, if this is an axiom, must be ready to cope with a more difficult problem in the way of frictional unemployment.

Mr. ROBEY. I don't know how much of an increase in frictional unemployment there is as the result of technological improvement. In most cases the technological improvement is a slow, fairly gradual

process. Much of the unemployment can be taken care of by shifting a worker from one job to another.

Representative CURTIS. I wish that were so. The figures don't indicate it because you have a decline in overall employment in manufacturing, while we have an increase in production. I think contrary to what you say, the shift sometimes is quite abrupt. Many people don't think of technological advancement in the comprehensive sense that I think they must. I pointed out that Shapley Hardware Co. in St. Louis just recently closed down because through improvements in transportation, I think essentially, the need for wholesale hardware, which was a great need a few decades ago, has disappeared. Just at a fell swoop some four or five hundred men and women are out of jobs.

So in the area of competition from foreign goods we have the same thing. I regard that in some degree a part of this technological advancement and growth. Certainly that creates unemployment in a very sudden fashion.

All I am posing is that we have the problem, and if indeed this is one of the costs of growth—I am not arguing against growth because I could not agree with you more—I don't like this business of arguing for something and then not being willing to face up to the costs that come as a result and then go to work on those problems. That is the only reason I raised this line of questioning.

Mr. ROBEY. I don't disagree with you in this. It is a question of how do you pay for this growth.

Representative CURTIS. That is right.

Mr. ROBEY. This wholesale hardware company that you mentioned—OK the shutdown happened suddenly. But the events leading up to it must have occurred over a long period of time.

Representative CURTIS. It is true.

Mr. ROBEY. Gradual development all along.

Representative CURTIS. Looking from the human standpoint, and we have to look at it from that angle——

Mr. ROBEY. The guy that got fired that morning was out of a job.

Representative CURTIS. We have to look at it from the economic as well as human standpoint. It is a sudden situation. I think growth follows that technique.

Because of that, I simply say that those who urge more growth, and I certainly would like to see more rapid economic growth, ought to at the same time be analyzing the problems that it creates.

Mr. ROBEY. I agree.

Representative CURTIS. We have had rapid technological growth in the field of agriculture, so rapid that it has been called a revolution and I think properly so. We have a very serious problem of unemployment in the rural areas. Some people like to call it forcing the little farmer off the farm. I don't call it that at all. I say he has found that he cannot make a livelihood due to this technological advancement.

Are the people who advocate more growth advocating more growth in the agricultural sector? They are the same ones who won't face up to the problem we have already created as a result of the very rapid growth we have had in that area? I was just trying to present this the best I can in a comprehensive light.

The CHAIRMAN. Thank you very much, Mr. Robey.

Mr. ROBEY. Thank you, sir.

The CHAIRMAN. We will meet at 2 o'clock with representatives of the Farm Bureau Federation, National Farmers Union, and National Grange participating for an hour and a half. Then at 3:30 the Committee for Economic Development and at 4 the Federal Statistics Users.

(Whereupon, at 12:35 p.m., the committee recessed, to reconvene at 2 p.m., same day.)

AFTERNOON SESSION

Representative PATMAN (presiding). The committee will come to order.

We have this afternoon Mr. W. E. Hamilton representing the Farm Bureau, Mr. Angus McDonald representing the Farmers Union, and Mr. Hershell Newsom representing the National Grange.

I assume we will take them in the order in which they appear here.

Mr. Hamilton, you have a prepared statement, sir?

STATEMENT OF W. E. HAMILTON, FARM BUREAU FEDERATION

Mr. HAMILTON. I do, sir.

Representative PATMAN. About how long will the statement be?

Mr. HAMILTON. I am not quite sure.

Representative PATMAN. You go ahead and take the time you feel you should take and then we will hear from Mr. McDonald and Mr. Newsom and then interrogate all three of you.

Mr. HAMILTON. Thank you, Mr. Chairman.

We appreciate this opportunity to comment on the President's Economic Report for 1960.

As citizens, Farm Bureau members have an interest in all aspects of the President's report. In the interest of time, however, we will confine our remarks to broad national issues and those that are of particular concern to agriculture.

Economic growth, the budget and inflation

The first chapter of the President's report presents some impressive facts on our national economic growth. The record of our past growth is a very real indication of the strength and vitality of our economic system. The only real internal dangers to a continuing high level of growth are the danger that we may destroy the sources of our economic strength by shifting too much responsibility to the Government, and the not-unrelated danger that we may destroy the basis for a free economic and political system by inflationary policies.

We agree with the President's comment "that we grow only by investing more and producing more, not simply by spending more."

We also agree that "when the Nation is prosperous, as it is today, with production, employment, and incomes rising, the most appropriate fiscal policy is one that provides a sizable excess of Federal revenues over Federal expenditures."

We are encouraged by the fact that the President's budget shows a surplus for fiscal 1961; however, we are concerned about the continuing upward trend in Federal expenditures.

The President has proposed expenditures of $79.8 billion for budgeted items, and $21.3 billion from trust funds—which are largely

supported by special taxes. Thus, the total Federal spending proposed for fiscal 1961 amounts to $96.3 billion after adjustments for certain offsetting factors. This huge total is slightly more than was spent by the Government when the cost of fighting World War II was at its peak.

We strongly recommend that the Congress attempt to enlarge the projected budget surplus substantially by holding down appropriations and new expenditure authorizations to the minimum needed to carry on proper Government functions.

The objective should be not only to make substantial payments on the national debt in periods of prosperity, but also to make possible at least some reduction in our tax burden.

Since budget deficits are to be expected in periods of recession, it is essential that sizable payments be made on the national debt in periods of prosperity if we are to prevent a continuing decline in the purchasing power of the dollar.

We note that the President has said that wage "settlements should not be such as to cause the national average of wage rate increases to exceed sustainable rates of improvement in national productivity," and also that "price reductions warranted by especially rapid productivity gains must be a normal and frequent feature of our economy."

We agree with this viewpoint, as far as it goes. The question of whether a wage settlement is inflationary often depends not so much upon its immediate effect on costs and prices in a particular industry as upon its impact on the national wage pattern in relation to national productivity.

We agree that gains in productivity should be utilized to reduce prices as well as raise wages. We would also note that the distribution of gains from productivity should reward capital sufficiently to encourage the savings of investments that are necessary for sustained economic growth.

The real question is, how can we achieve such a distribution of our gains in productivity? We doubt that it will be achieved by exhorting various economic groups to be reasonable in exercising any economic powers they may have. The real answer will be found in policies that promote competition, and prevent the exercise of monopoly power by any group—whether it be agriculture, labor, industry or the Government itself—to force up prices and wages.

We must have an effective antitrust program. We must find some way of creating conditions that will facilitate the settlement of labor-management disputes on an economic basis without hardship to the general public and without recourse to government coercion on either side. Finally, we must avoid succumbing to the temptation of trying to protect inflated wage and price levels by raising barriers against imports.

Federal debt is a major factor in our present inflation problem. The deficits that created this debt are responsible for much of the inflation that we have already had. The task of preventing further inflation is complicated by debt management problems. This is well illustrated by the controversy over the present ceiling of 4¼ percent on the interest rates that may be paid on long-time Government bonds. The failure of Congress to eliminate this ceiling last year has forced the Government to confine its recent borrowings to the short term

market. This is inflationary. It is costly for farmers and others who have had the cost of needed operating credit raised by the competition of increased Government demand for short term funds. It may also prove very costly to the Government. Short term interest rates are now higher than long term rates, and some analysts think that this may prove to be the case for some time to come.

Farm Bureau agrees with the President that the ceiling on interest rates should be removed. Interest is a price for the use of money; consequently, it will vary with supply and demand if left free to do so. The sound antedotes to rising interest rates are a Federal budget surplus, to reduce demand, and increased savings to increase supply.

The alternative of holding interest rates down by an easy money policy is unacceptable to Farm Bureau, because it is the road to inflation. The recent flow of gold should also warn us that it may not be possible for the United States to hold interest rates too far below the levels prevailing in other countries.

Taxes

We do not have specific policy on all the President's tax recommendations. We agree that it probably will be necessary to continue the corporate income taxes and most excise taxes at present levels for another year. However, we recommend that the amendments adopted last year to terminate the tax on local telephone service and reduce the 10-percent tax on passenger transportation to 5 percent on July 1, 1960, be allowed to go into effect. The taxation of local telephone service should be left to State and local authorities. The transportation tax was imposed not only to raise revenue, but to discourage unnecessary travel during the war. We do not believe that it is sound national policy to continue to discourage travel. The tax on aviation fuel should be extended to jet fuel to avoid discrimination and to partially repay the Government for public expenditures on airways and airports.

We are opposed to the proposed increases in the amount and duration of the emergency portion of the highway fuel tax. Instead, we recommend that the scheduled completion date of the Interstate Highway System be postponed as necessary to keep the program on a pay-as-you-go basis.

We agree that corrective amendments are needed in the tax laws applicable to cooperatives. We believe that all net savings and income of farmer cooperatives should be subject to a single Federal income tax, to be paid either by the cooperative or by the patron, as earned. We will support amendments to the tax code to accomplish this objective.

Agriculture

From the standpoint of agriculture, the outstanding feature of the President's Economic Report is the series of statistical tables which appear on pages 229 through 236. The facts presented in these tables make it clear that agriculture has made a tremendous contribution to the economic growth of this country in the last 30 years. As is pointed out on page 102 of the report, production per man-hour in agriculture has been growing at a rate of 6 percent per year in the last 10 years. This is two to three times the rate at which nonfarm output per man-hour has been increasing.

Farm production has been increasing not only in terms of output per man-hour, but also in terms of output per unit of total input. The continuing ability of agriculture to increase output per unit of input has contributed to economic growth in other sectors of the economy by releasing resources—particularly man-power—for the production of nonfarm goods and services.

The tables on pages 229 through 236 also bring out some points that are often overlooked in discussions of the recent trends in farm prices and national farm income statistics. While total net farm income has declined from the all-time high reached shortly after World War II, migration out of agriculture and the increasing amounts of income received from nonfarm sources have helped to maintain per capita income to a far greater extent than most people realize. This is illustrated by table D–65 on page 229.

Although per capita income declined in 1959 due to a number of factors, including a smaller wheat crop and cyclical declines in the prices of some commodities such as hogs, it was still the fifth highest on record. We do not mean to imply that farmers are happy with their present incomes. Our point is that on a per capita basis the farm income situation is not nearly as desperate as it has sometimes been pictured. An important part of the income received by farm people now comes from nonfarm sources; however, this indicates that some progress is being made toward the solution of a very important problem. We must remember that many of the people who are classified as farmers by the census do not have adequate resources for full-time agricultural employment on their own farms.

Per capita net farm income has been strengthened not only by increasing earnings from nonfarm sources, but also by the migration of farm people into other activities. From 1929 to 1957 there was a net migration of 21,145,000 people away from the farms as improving technology reduced farm labor needs and released workers for the production of other things. If the 21,145,000 people who migrated had stayed on the farm, the income from farm sources that is now divided among the 21.2 million people still on farms would have to be divided among approximately twice as many. In this case we would really have a farm problem. If no one ever left the farm, we would seen have a peasant type of agriculture that would weaken our entire economic structure. Yet there are those who feel that an important objective of farm policy should be to prevent the type of adjustments that are reflected in the migration that has been taking place for many years.

The basic problem in agriculture is that our output has been expanding faster than our markets. This has been made possible by improving technology, but the problem has been aggravated by government programs that have impeded needed adjustments. The current farm income situation reflects the fact that surpluses accumulated under price support programs have depressed farm prices while inflationary forces have been boosting farm costs. The data on realized gross farm income, production expenses, and realized net farm income, presented on page 229 of the President's report, clearly illustrate what has been happening. The alltime high in realized net farm income was reached in 1947. Since that time total gross income has gone up $2.5 billion, but production expenses have gone up $8.9 billion; and realized net income has gone down $6.3 billion.

Considerable progress has been made toward putting farm support price programs on a more realistic basis; however, further action is urgent, especially in the case of wheat.

Farm Bureau's wheat policy calls for four specific changes in present legislation—all of which are essential parts of the whole solution. The four point program would:

(1) Eliminate all acreage allotments and marketing quotas, effective with the 1961 crop of wheat. This would permit each wheatgrower to determine—for himself—the acreage of wheat on his farm which would make the most efficient use of his land, labor, and machinery. It would leave the traditional wheatgrower free to produce wheat at what he feels to be his lowest possible unit cost of production.

(2) Base price supports for wheat—beginning with the 1961 crop—on the support level for corn, with adjustments for differences in weight, nutritive value, and buyer preference. However, for the 1961 crop of wheat the price support would not be less than 120 percent of the price support for corn.

The price support for corn under current legislation (the Agricultural Act of 1958) is set at (*a*) 90 percent of the national average price received by farmers for corn during the preceding 3 years, or (*b*) 65 percent of parity, whichever is higher. The 1959 national average price support for corn is $1.12 per bushel, which is 90 percent of the average price received by farmers in 1956, 1957, and 1958.

For most purposes, wheat is a highly nutritive livestock feed that is worth slightly more than corn on a pound for pound basis. It is also heavier on a per bushel basis. Therefore, adjustments for these differences—and for buyer preference—would normally result in a higher price support for wheat on a per bushel basis than for corn.

The provision that the support price for the 1961 crop of wheat could not be less than 120 percent of the corn support price would result in a wheat price support of at least $1.30 per bushel if corn were supported at $1.08 per bushel.

This price support policy would—

(*a*) Restore the pricing of wheat to supply-demand conditions as reflected in the marketplace. (This does not necessarily mean that the market prices of wheat and corn would fall into the exact relationship indicated by differences in feeding value. The relative market values of corn and wheat are affected by domestic and foreign demand for milling wheat, and by the fact that a great deal of wheat is produced in areas where corn prices reflect substantial transportation costs.)

(*b*) Expand the use of wheat for livestock feed without creating unfair subsidized competition for the producers of corn and other feed grains. (In the 20-year period, 1930–49, excluding the abnormal war years, 1940–44, market prices averaged almost 28 percent higher for wheat than for corn, and an average of 15.1 percent of the total wheat production was fed to livestock. For the 5 marketing years, 1955–59, it is estimated that wheat market prices have averaged 58 percent above the corn prices, and that only 4.9 percent of the total wheat production has been fed to livestock.)

(3) Provide adequate protection for all farmers from the competition of Commodity Credit Corporation sales from accumulated wheat stocks:

The CCC now has over 1.4 billion bushels of wheat in inventory and under loan. The proposed protection would be made effective by providing that no wheat could be sold for domestic use by CCC at less than 150 percent of the effective support price, plus reasonable carrying charges. For example, if the support price for wheat should prove to be $1.30 the first year under the new program, the unrestricted CCC release price would be $1.95 plus carrying charges. Future foreign sales of wheat from CCC stocks under Public Law 480 (the Agricultural Trade Development Act) would be restricted to the average of such sales in 1957, 1958, and 1959 when a substantial portion of such sales came out of current marketings.

There would be no limit on foreign donations of CCC-owned wheat for famine and disaster relief.

Several years would be required to dispose of current CCC stocks in this manner. However, domestic prices would be free to rise with market demand, unhampered by competition from surplus Government stocks.

(4) Cushion the effects on wheat producers and on producers of other feed grains caused by the reduction in the support level and the elimination of acreage allotments and marketing quotas. This would be done through a substantial expansion of the soil bank conservation reserve program: As a general policy, we recommend the extension of USDA's authority to enter into new conservation reserve contracts for 3 years—through 1963—with a modest expansion in appropriations for this period. This recommendation would expand the conservation reserve at a rate of around 5 million acres per year to a total of 43 million acres in 1963.

In addition, as an integral part of the legislation we are proposing for wheat, we favor a provision to raise the total amount of land in the conservation reserve from the 43 million acres proposed above to 60 million acres at the end of 3 years. At least half of this proposed additional authorization of 17 million acres should be signed up the first year to cushion the adjustment to the proposed new wheat program.

This expansion of the conservation reserve would cushion the adjustments faced by two types of wheatgrower: (*a*) The grower who is farming marginal land in traditional wheat areas; and (*b*) the grower who has become a wheat producer under the 15-acre exemption and who may choose not to grow wheat under the new program.

Each of these four parts of our program is essential to the others. We cannot support the elimination of acreage and marketing controls without an adjustment in the level of support. The level of support cannot be reduced without protection to growers from competitive sales of Government-held surplus wheat. A substantial expansion of the soil bank conservation reserve is dependent upon—and justified by—adoption of the other sections of the wheat program.

In conclusion we want to say a few words with respect to the present corn situation, since we are proposing that wheat be given a program comparable to that already in effect for corn. It has been said by some that corn production reached a record high in 1959 because "farmers boosted production to make up for lower prices."

Here are the facts:

(1) The support price was raised, not lowered, in 1959 for approximately 90 percent of all corn produced in the United States.

(In 1958 there were three support prices: $1.36 per bushel for commercial area farmers who complied with acreage allotments; $1.06 for those who did not comply; and $1.02 for the noncommercial area. Only about 12 percent of the corn produced in the commercial area was eligible for the compliance rate of $1.36. Since the commercial area accounted for about 82 percent of the total crop, less than 10 percent of the 1958 crop was eligible for support at a rate in excess of $1.06. In 1959 all corn was eligible for support at an average rate of $1.12.)

(2) In 1958 approximately 6.7 million acres of land allotted to corn were held out of production under the acreage reserve program. With the expiration of the acreage reserve, most of this land presumably was returned to corn in 1959.

(3) Support prices for grain sorghums, barley, oats, rye and soybeans—all of which compete with corn for acreage—were reduced substantially in 1959.

(4) Weather contributed to achievement of the record 1959 corn yield. Farmers have made great progress in overcoming natural hazards, but they have not yet completely isolated crop yields from the effects of wind, hail, drought, floods, and unseasonable freezes. None of these was a serious problem over an extended area in 1959.

If farmers were inclined to increase acreage to offset lower prices, they should have increased the acreage seeded to sorghums, oats, barley, rye, and soybeans, rather than acreage seeded to corn in 1959. Actually, there was a small increase in barley acreage, but a net reduction of at least 4.4 million acres in the total acreage devoted to grain sorghums, barley, oats, rye, and soybeans. The acreage released from the acreage reserve, plus the reduction that took place in the acreage devoted to crops for which support prices were lowered, more than accounts for the increase that took place in corn acreage.

It is also interesting to note that prices of oats, rye, and soybeans have been higher this year than in the 1958 marketing year when price supports were at a substantially higher level. This must be a great surprise to those who predicted that prices of the coarse grains and soybeans would drop to the new support levels.

Our present feed supply is burdensome because of the stocks accumulated under past programs, but utilization has been increasing as price support levels have been lowered. For example, in the 1958 marketing year the total utilization of corn was greater than our production for any year prior to 1958. The disappearance of corn from all storage positions during the October to December quarter of 1959 was 1,067 million bushels in comparison to 985 million bushels in the final quarter of 1958. This indicates an increase of 8.3 percent in utilization in the first quarter of the current marketing year.

There is no question but that the utilization of corn in the full 1959–60 marketing year will be greater than our production in any year prior to 1959.

While livestock prices have declined somewhat as feed consumption has increased, the fact remains that we are proving once again that markets can be expanded and that there is a way to move an increasing volume of farm products in consumption. We are demonstrating

once again that livestock is the balance wheel of American agriculture—a mechanism that can and should be used to adjust our output to the capacity of our markets.

Representative PATMAN. Thank you, sir.

Mr. McDonald, will you proceed.

STATEMENT OF ANGUS McDONALD, NATIONAL FARMERS UNION

Mr. McDONALD. Mr. Chairman and members of the committee, a cursory examination of the President's Economic Report leads us to believe that this administration intends to continue to pursue policies which are not in the best interests of agriculture, small business or the American people as a whole. The report also indicates that the administration does not yet see and is not aware of the administered price system which has made its theory of monetary control of the economy outmoded and obsolete.

The agricultural policies of the Secretary of Agriculture which the administration pursues are not in the best interest of the American farmer. Such policies have caused a severe decline in farm income. There is evidence that Secretary of Agriculture Benson's theories are fallacious. For example, he attempted to reduce corn production last year by taking off controls and lowering price supports. The result was a 4.4-billion-bushel corn harvest, a record which upset all previous records.

We are at a loss to understand why everyone cannot see that a reduction in acreage or bushels or pounds of surplus crops is the only solution to the problem of overproduction. The Congress clearly understood this when it passed a bill cutting wheat acreage by 25 percent. Since President Eisenhower vetoed this legislation, it is clear who is responsible for the continued wheat surplus. It is unfortunate and tragic that American farmers must suffer because of the administration's mistaken and benighted policy.

Equally inimical to the interest of the American farmer is the administration's monetary policy. Personal income from interest has jumped from $12 billion in 1952 to a rate of $24 billion. This is about two and one-half times greater than farm net income is expected to be in 1960. Farmers' interest rates have skyrocketed. According to the Farm Cost Situation, rates of some production credit associations are approaching 9 percent. It is estimated that farm mortgage loans amount to $12 billion and non-real-estate loans to $11 billion, two all-time highs. I call attention to the following paragraphs in the Annual Report for 1959 of Farmers Union Grain Terminal Association:

TIGHT MONEY AND HIGH INTEREST

We regret to say we are obligated to charge 7 percent interest to our affiliates on a monthly compound interest basis. A few years ago, we borrowed $30 million at a prime rate of interest of 2 percent, with an interest cost of $600,000 a year. That same $30 million today would cost us $1,500,000 a year just for interest. The cost of interest on $30 million has gone up until now it is almost a million dollars a year more than it was a few years ago. Naturally, higher interest makes the savings a great deal less. You may, and should, feel aggrieved at the high interest cost, but the problem today is to get the credit that's needed at any cost.

So far, GTA has had no trouble in borrowing what it needs for itself or its affiliates, but, of course, we have no control over the interest rates. The base of the interest rate is settled in Washington by the Federal Reserve Board of

Governors. When it announces its interest rate is 4 percent, you can be sure that is the base interest that the banks will charge, plus their margin of profit. Today, the "blue ribbon," prime interest rate is 5 percent, but the banks "expect" you to leave at least 15 percent of what you borrow in the bank, which is called a compensatory balance. In other words, you can use only 85 percent of the money you borrow, but pay the 5 percent interest on the whole loan. A prime rate of 5 percent today, after you allow for the money that lies in the bank as a compensatory balance, brings the actual interest cost up to 6 percent, even for those who enjoy the prime rate. This is creating a critical state of affairs in the financing of this Nation's economy.

The responsibility for an unfortunate policy should be shared by the Treasury Department and the Federal Reserve Board which apparently operates as an independent branch of Government responsible to no one. Although the Constitution of the United States says that the power to coin and regulate money shall reside in Congress, the Federal Reserve Board has apparently usurped that power.

According to our information, William M. Martin, Jr., has paid little attention to the members of this committee. He apparently thinks that what is good for the bankers is good for everybody, including the farmers.

I will not consume the time of this committee reciting facts and analyses brilliantly set forth both in the staff report of December 24, 1959, and the committee report of January 26, 1960. I also call attention to an analysis by Dr. Seymour E. Harris published as part 7 of the "Hearings on Financial Conditions of the United States."

Attempts have been made in the newspapers and magazines and in other places to convince the American people that interest rates, like Topsy, "just growed" and that the administration has only been following the market—not leading it. The record indicates otherwise.

On February 15, 1953, close to $9 billion of certificates—all at an interest rate of 1⅞ percent—had to be refinanced. The Secretary of the Treasury offered to exchange them for certificates of the same duration bearing an interest rate of 2¼ percent—an increase of three-eighths of 1 percent.

On May 18, the Treasury announced that close to $5 billion of 1-year certificates, bearing an interest rate of 1⅞ percent and maturing June 1, would be refinanced at a higher rate. The Secretary of the Treasury offered to exchange the maturing issues with certificates of the same duration, bearing an interest rate of 2⅝ percent—an increase of three-fourths of 1 percent.

At the same time, the Secretary also announced the calling of $750 million of 2-percent, 15-year bonds scheduled to mature in 1955. In exchange for the bonds called for redemption on June 15, the Treasury offered 1-year certificates bearing a rate of 2⅝ percent—an increase of five-eighths of 1 percent over the rate on the 15-year bonds.

Beginning May 15, the Treasury offered to replace $5 billion of outstanding 1.78-percent, 2-year savings notes with a new issue ranging from 2.16 percent, if held for 6 months, to 2.47 percent if held 2 years to full maturity.

Following a number of conferences between Deputy Secretary W. Randolph Burgess and leading investor groups, including representatives of life insurance companies and commercial banks, the Secretary of the Treasury announced on April 8, 1953, that the Treasury Department would issue $1 billion of 30-year bonds at 3¼

percent. This rate was three-fourths of 1 percent above the previously comparable bond offering in 1945, the 2½-percent Victory bond.

In response to the offering, the Treasury received applications to subscribe for 8½ times the amount of bonds offered. This was "screened" down to $5¼ billion. On April 29, subscribers were allotted their proportionate shares in the $1.1 billion of bonds that the Treasury issued.

But this was only the beginning. Except for the recession period, roughly the years 1954 and 1958, the administration in cooperation with the Federal Reserve Board has driven interest rates up until they are above the 4¼-percent ceiling.

The relation of other interest rates to Government security interest rates is well known and needs no documentation.

Now the administration is obsessed with removal of the ceiling. It is referred to on pages 19, 21, and 55 of the Economic Report. And it is referred to on page 43 in connection with the 4-year, 10-month, 5-percent certificates. This is the issue, as I recall, that was oversubscribed 12 times, which indicated that it was underpriced.

The administration indicates that an interest ceiling is a novelty. I call attention to a colloquy between the chairman of this committee and Senator Monroney on January 27, 1960, Congressional Record, page 1259:

> Mr. MONRONEY. I was very much interested in what the distinguished Senator said about the charge of fiscal irresponsibility or monetary irresponsibility being made against the majority of the Joint Economic Committee.
>
> I have read most of the articles written by the financial writers during the current period of rapid escalation of interest rates.
>
> Mr. DOUGLAS. Which the Senator from Oklahoma has so well stated. Notice how they go up, up, up, higher, higher, higher.
>
> Mr. MONRONEY. I think the majority has shown much more fiscal responsibility and monetary responsibility than the financial writers. I refer to such financial writers as those on the Wall Street Journal and the New York Times, and more particularly the financial writer for the Washington Post and Times Herald, none of whom has ever found it necessary to give the history of the 4¼-percent ceiling which now exists on long-term bonds.
>
> Surely those who purport to write for the Nation on financial matters should exercise some journalistic responsibility before they begin to charge the distinguished committee, Members of Congress who have had years of experience in this work, with fiscal and monetary irresponsibility. Those writers would only have to look up a little of the history of the United States to find that no President in history, from George Washington until the present occupant of the White House, has ever been given the right to issue long-term bonds without having the interest ceiling fixed by Congress.
>
> The Library of Congress has performed research on this subject for me, and I checked it, to be doubly certain, with experts from the Federal Reserve Board. This is a historic fact. How can President Eisenhower ask for powers which no other President has ever had and demand a complete surrender of congressional power, which Congress, throughout the Nation's long history, has insisted upon retaining.

Finally, I comment on the assertion that the high-interest, tight-money policies have brought about an increase in the proportion saved or invested.

Here are percentages indicating the proportion of the national product saved computed from statistics on page 87 of the January 1960 Federal Reserve Bulletin. 1954, 22.3 percent; 1955, 25.6 percent; 1956, 26 percent; 1957, 24.9 percent; 1958, 21.2 percent, 1959, 24.9 percent.

Mr. Chairman, I want to add just a little bit to the material on the proportion that people save and for what reasons they save. According to a Ford Foundation survey titled "Wealth of the Nation," survey headed by John J. McCloy, published in June 1959, Library of Congress card No. 59-12-21, according to this survey which was a nationwide survey, when individuals were queried as to why they saved, 98 percent answered that they saved for their old age, 60 percent said they saved for emergencies, 40 percent for child education, 29 percent for child inheritance, 18 percent for items such as cars, 17 percent for a trip, 17 percent for housing, 14 percent to pay off debts, and 2 percent for no reason.

According to this survey, there was no one who indicated that he saved because he could get more interest on his savings.

Representative PATMAN. Thank you, Mr. McDonald.

Representative CURTIS. So he could get what on his savings?

Mr. McDONALD. Higher interest.

Representative PATMAN. I recall that survey.

Mr. Newsom, you may proceed, sir.

STATEMENT OF HERSCHEL D. NEWSOM, MASTER, THE NATIONAL GRANGE

Mr. NEWSOM. It is always a privilege to appear before members of this committee relative to the subject matter of the President's annual economic report. The fact that the destiny of the free world hinges directly on the success of our own system currently adds emphasis to the already pressing necessity that we as Americans pool our experiences and devote our best efforts and thinking to the task of perfecting and enhancing our own national welfare.

It is apparent that the struggle between the two systems of the world will go on for a long time. We must meet the challenge with controlled patience, but with steadfast perseverance. The outcome depends on the preservation of a system that recognizes and respects the innate dignity of man and rewards individuals according to their contributions to the general welfare. In our modern political and social structure we have recognized the necessity of temperate departure from this principle in some cases, but we must not abandon the principle itself.

This struggle clearly puts our peculiarly successful private enterprise system to severe tests. We are competing with a power capable of regimenting all of its natural resources, human and material, to attain its national goals. In short, we are competing with a system that utilizes slave labor as well as one that controls the material and nonhuman productive resources; one that drains the economy of its potential living standards whenever, in the judgment of government, this is essential for the benefit of the central power; one that uses propaganda as one of its numerous instruments to destroy those who stand in the way of its progressive envelopment of the world.

As envisioned by the wise framers of the Employment Act of 1946, it is well that representatives of the economic segments of our Nation come together under a broad exercise of the prerogatives of self-government to annually counsel with this committee concerning the Committee's report dealing with the content of the President's Economic Report.

Before going into the content of the report, I would like to express general satisfaction with the clear, concise and to-the-point manner in which the President's report has been built. Without getting into the controversy over the potential level of economic activity that this country might enjoy under certain theoretical conditions, I believe it is clear that the Congress, the administration, and the private sectors of our dynamic economy have jointly and collectively influenced the economy well. The 15-year adjustment period after World War II has not degenerated into a major depression. It is true that we have had three rather marked recessions, but as a nation we have weathered these recessions well. This record is especially significant when one considers that over a prolonged period we have roughly put 10 percent of our gross national product into our defense effort, yet our average living standard continues to rise significantly. The Grange is pleased, of course, that 1960 looks like it will be a good year for most sectors of our economy.

We are distressed and impatient, however, that our own vital segment of the economy—the rural segment—is distressed and obviously has prospect of even greater depression.

It seems apparent to us that as a nation we should develop means by which American agriculture can capitalize on the best (and in many circumstances the only) market available to our own agricultural producers—our own primary domestic market—without necessarily permitting the production over and beyond that required for such primary domestic market from destroying the price level on the total level of production.

We could thereby take advantage of that general prosperity, built under a philosophy of soundly regulated and governmentally influenced pricing and trade policies, so that the greatest single missing link in a long chain of progressively rising levels of economic activity can be forged before that missing or weak link threatens the total chain as it did in the twenties and was finally made manifest in the early thirties.

American farmers, and rural people directly dependent upon them, have long been among the major victims of both inflation and deflation and of the forces that bring about these results. Indeed, it was in an era of declining purchasing power of the dollar and consequent rising costs of agricultural production in which American agriculture lost $34 billion in equity in the decade of the twenties. Ironically, many economists were, in that very period, writing about the Nation's great era of prosperity.

The point that I want to make with this committee is that the Grange clearly recognizes that farmers and other new-wealth producers for the most part have historically been left behind in inflationary periods. It should be clear, then, that farmers have much more to lose in an inflationary spiral than has sometimes been recognized. This drives us to the conclusion that even though current agricultural income levels dictate that we must do everything legitimately to hold down agricultural costs, history likewise dictates that over a longer period of time we have had also a great stake in preventing further inflation.

The Grange then is greatly concerned over the factors that have generated rising real estate prices, when such rise is not justified by the

earning power of the real estate itself. This is an unmistakable danger signal.

The tremendous demand for capital not only in agriculture but in the whole economic structure is another indication of the tempo of our economic activity. This is in large part a matter of substitution of improved equipment for man-hours. The contribution that this process makes to our living standard in America—both rural and urban—will depend upon our ability to translate the improved "per man-hour efficiency" into a sound division of benefits to three parties.

1. Unless the producer—from the standpoint of management and ownership—realizes a reasonable profit from such substitution, then the proper amount of capital for continuing the process is not going to be available long.

2. Unless the worker—be he farmowner, operator, manager, or one who has no direct responsibility except through the quality and diligence of his labor in a factory—receives compensation in reasonable proportion to the production resulting from that work, then the substitution of equipment for his labor may well be a threat to his living standard, and indeed to the living standard of all American workers—both rural and urban.

3. Unless society as a whole—our consumers and users of the products of such industry where this substitution is made—receives reasonable benefit from the increased efficiency, then the rising living standard which is necessary to generate both the purchasing power and the capital will be diminished or absent. In this event, "bids" for capital required will inevitably raise the cost of such necessary capital.

This, Mr. Chairman, is the basis of our great concern over the impending results on rural America—sure to follow unless all Americans become more, not less, conscious of the income and economic distress in American agriculture.

If I need be more specific, let me say that those who propose to solve the "farm-surplus problem," as they still choose to refer to it, by simply reducing the income of those who produce such products would certainly not serve America well.

The closer interrelationships of all segments of our society require more intelligent concern, not less, for the problems of all Americans.

Consistent attempts to solve the persistent low-income problem in American agriculture within the business of agriculture, without taking account of this increasing interdependence and interrelationship of farmers with all other Americans, are clearly destined to failure.

To be blunt, it is crystal clear that more is required than simply juggling the level at which Government establishes a "price support" level under existing legislation with respect to feed grains, wheat, and cotton—either up or down. A more significant change in national agricultural legislative provisions is required.

As some of the members of this committee are aware, some of our continuing difficulty in connection with the above subject matter stems from the fact that a cheap food and fiber and raw material policy has been demanded to cushion the inflationary spiral. The cost-of-living index is lower, due to this cheap food and fiber policy, than it would be if the products of agriculture had kept pace with the upward tempo set by other segments of the economy.

Part of our inability to depart from the present unsound program has stemmed from the fact that many of the proponents of continued adherence to the present program for agriculture—both those who want to continue the present program at lower fixed prices and those that seek higher prices under the present program—have confused the importance of holding down the index of cost of living with the prevention of further inflation.

I would only say to you that we cannot tolerate a continued insistence that we can solve the low-income problem in agriculture entirely within the business of agriculture by simply talking about eliminating a portion of the surplus production when that surplus in itself, that seeming surplus, is really an effect and not a basic cause of our problem.

To continue to pay a portion of that cost of living through taxes only temporarily holds down the cost of living. I am calling your attention to this statement because one of the basic objectives that we consistently have to any effective modification of the present method of trying to do about the farm income problem is that it is better for the economy as a whole to pay a part of the cost of food through tax subsidy than it is to assess that cost against the users and consumers of the food. Therefore, some of that want to make certain kinds of changes get branded with the label of bread tax and this type of thing. I am saying I don't want to run from that label. I want to face up to it because I firmly believe that we must as a nation face up to it. It is nonetheless inflationary—in the final analysis it is even more inflationary—to pay substantial portions of that cost in taxes.

Such a policy as we propose would, in our opinion, help to put more self-control in the demands of the other segments of the economy. The self-discipline that might result under such circumstances would seem to give far greater promise of successfully resisting the temptation of further inflation.

Each of us can perhaps be relied upon to be more conscious of the total national interest, in exact proportion to the close tie between our own pocketbooks and that total national interest. To this extent inequitable income opportunities or unequal bargaining power, as between one segment and another, is in all probability one of the greatest and most serious threats to balanced and continuous economic progress in America.

Obviously neither farmers nor any other sector of the American economy should be made completely vulnerable to the impact of full "free" or foreign competition. At the same time, we must endeavor to progress in the direction of taking account of that competition and guard against pricing ourselves needlessly out of either our own or international markets. In the long term, U.S. national welfare cannot thereby be served well.

Whether or not, as the President's message suggests, we have or can develop a satisfactory, broad base of public understanding to discipline the forces at work in today's inflationary picture is problematic. There is, in our opinion, one way. That way is to be found in dedicating ourselves to a determined effort to provide equitable opportunities for all Americans in terms of bargaining power and market regulations to achieve income consistent with the actual contribution made

to general welfare. There will be less danger of abuse of power, either in "collective bargaining" or "protective pricing mechanisms" as we have them today, if we have a balancing economic power in the hands of other Americans. This must, therefore, be our objective.

I should like to say simply, Mr. Chairman, that the section of the Economic Report beginning, I believe, on about page 100, is to me statistically a very important and well-done section. I am immensely disappointed, however, that there apparently is no constructive remedy for a situation that we view with increasing concern as farm income continually trends downward and as the return on farm labor and farm investment does not fall within the category of the criteria that we have tried to lay down that will return the American living standard in rural areas but will provide the necessary development of capital without putting us into a situation where we may be tempted to ask for subsidized interest rates or something of that sort in desperation.

The Grange will continue to support a carefully balanced budget operation of our Government. We will continue to insist that in times of prosperity we must seek to provide an excess of income over expenses and a corresponding ability to reduce Government debt. It is our consistent position that tax changes should only be made at a time and in a manner in accord with this purpose; and that, therefore, no general tax reduction—or increase in personal exemptions—can be seriously considered under present circumstances.

The Grange supports the achievements of the purpose of the 1951 taxation measure with respect to farmer cooperatives. We must oppose the President's recommendation for an increase in highway fuel taxes. Increased costs that are developing in the interstate highway structure are due in part to the requirements laid down by the Department of Defense. We believe, therefore, that serious consideration should be given to paying such portion of the increased cost out of general revenue rather than to extract that amount from highway users.

Likewise, the Grange will support the move to remove the 4½ percent interest rate ceiling on governmental securities with a maturity date of 5 or more years. All of these proposals will have a bearing on the degree of inflation that we will experience in 1960. To hold to a legislatively established "ceiling" on interest rates—regardless of the "market demands" for capital—is to ignore the origin of the real problem which we confront.

Here we shall have to take issue with our friends on either side of the argument because some of them did not take account of the origin and cause of the interest rate rise.

Turning again to the strictly farm picture, I am particularly pleased with the section of the President's report, beginning on page 100, which analyzes the agricultural picture of today. It is a constructive piece of work.

There is one statement, however, in this section of the report that I would like to comment upon, which is: "Agriculture as an industry continues to be in a financially strong position." This statement presents a favorable agricultural picture in terms of assets compared with liability. It is true that such a picture exists in terms of figures presented. Even though our net income in 1959 shrunk $2 billion and even though present income from farming invites a national tragedy, our balance sheet does look pretty good.

Our problem is that we have huge amounts of capital tied up in our agricutural business in land, buildings, and equipment, and that this capital is costly to maintain. For instance, as farmers bid against themselves for more land and as they bid against nonfarm interest anxious to cushion itself against further inflation, they are merely bidding up their taxes and other overhead costs out of all reasonable proportion.

I would like to point out to the committee that there is not another industry in America that has to extract nearly half of its capital structure out of that plant every generation to pay off the people that move from the farm into urban areas. This constitutes a problem that makes the mere figures that enter into the compilation of this balance sheet terribly misleading.

Getting into the agricultural legislative recommendations of the President as carried in his Economic Report, it is what is not said rather than what is said that causes the Grange grave concern. The report carries no realistic recommendations for solving the farm income problem. Nor is there even any recognition in the report that anything more than a "full, free market"—to get the Government out of agriculture is needed. This vacuum which has continued now for several years presents a threat to our national well-being. It is not only unfair for farmers to continue to remain the "low man on the Nation's economic totem pole," it is extremely unwise.

Low farm prices and inequitable farm income short circuit a vast potential of buying power that springs from nearly 5 million farms.

The consequences of low farm income threaten to impose higher consumer food bills in three ways:

1. Low farm income attracts to farming, as a rule, only the less able young people. This inevitably means lowered efficiency and higher production costs. Eventually higher food bills will result. The Nation has a vital interest in preventing this.

2. Unless we solve the farm income problem we will be forced to rely to an increasing amount on "outside" capital to finance our business. You have seen what has happened to the broiler industry. In short, he who pays the fiddler calls the tune. This means he who furnishes the money will often furnish the management. This is the road to the corporation farm; it is the road away from the family-type operation, involving individual ownership and management. What will happen to the price of food when the corporate farm becomes a dominant factor?

3. Unless we solve the farm-income problem—equitably and with a real concern for both the families involved and the desirable kind of a social and economic pattern in rural America—the technological revolution in the production of food and fiber will be slowed materially. Fewer and fewer producers, despite the pressure to increase efficiency, will be able to afford the more expensive methods of increasing efficiency. Most certainly in the long run this tends toward higher production and marketing costs—higher cost to the consumer—and a lowered living standard. I would hasten to add that we recognize full well that there is a certain amount of this adjustment that one of the previous witnesses has referred to is highly desirable. But we do not want that adjustment artificially stimulated by ruthless or unwise governmental policy.

In short, perhaps today's greatest challenge to our Nation, outside of our defense effort and other efforts dealing with our place in today's world, has to do with the place of rural America in our total national structure.

I do not at this time propose to go into our recommendations as to how to solve this income problem, but I stand ready at any time to bring these recommendations to this or any other group.

America's farms and her rural areas may well be required in the future as in the past to produce more than mere food and fiber in the interest of a consistently greater total national structure.

Representative PATMAN. Thank you very much, Mr. Newsom.

Senator Sparkman is recognized first.

Senator SPARKMAN. Mr. Chairman, I suppose all three are up for questioning.

Representative PATMAN. That is correct.

Senator SPARKMAN. And any and all may answer or comment on any question addressed to any one; is that correct?

Representative PATMAN. That is my understanding.

Senator SPARKMAN. Mr. Newsom, let me first say I found myself constantly waiting for your recommendations until you got to the very last paragraph when you said you were not going to deal with the recommendations here. I think your paper is a very good discussion of the farm situation, but I think one thing that we are in great need of is a farm program to be worked out. I think we have postponed it about as long as we can afford to, don't you?

Mr. NEWSOM. Longer than we can afford to.

Senator SPARKMAN. Yes. I remember this. My first year in Congress was 1937. We finished that year, Congressman Patman, about May and went home. We were called back into special session on September 15 by President Roosevelt, to draw up an adequate overall farm program. We did not succeed. We have been working at it ever since. We have not succeeded yet, have we?

Mr. NEWSOM. That is a matter of degree. If the question is one that I can comment on, I would like to say that reasonable success has been attained or at least approached time after time but this is a dynamic structure we are in.

Senator SPARKMAN. You think it is a changing condition that probably has kept that from being an all-time adequate program?

Mr. NEWSOM. I do.

Senator SPARKMAN. You do think at the present time we need something done?

Mr. NEWSOM. We have been needing very substantial change ever since we started to move out of the Korean war period. We were needing a very substantial change as we moved out of World War II. We had begun to need that change worse and worse until the Korean war came along.

The Senator will recall that the present structure was clearly designed as an adjustment sort of program in a postwar period. It did serve some very effective and good results in that sort of circumstance. But, Mr. Chairman, Senator Sparkman, and Congressman Curtis, the fact that as we move further and further away from the wartime dislocations of production patterns and marketing patterns of the Korean war—our most recent distortion, of course—into what

all of us hope is a prolonged absence of this kind of wartime dislocation of production and marketing patterns—we have to take a new look at the aspects of many of our programs. We have a lot of progress from which we can profit if we will look at the record. We have some excellent and effective marketing orders and marketing agreements. We have a very successful sugar program. I am not thoroughly in accord with the way the allotments are being set. I can find some fault with some other aspects of the administration of the Sugar Act; but the basic idea of regulating marketing and of getting income for American producers out of American users and consumers of the product, which is inherent in the marketing agreement philosophy, inherent in the Sugar Act, inherent in the Wool Act, gives us a pattern that I think we ought to try to follow.

Senator SPARKMAN. Can that be followed in the other basic commodities, do you think?

Mr. NEWSOM. We think so. We concede that we do not have a perfectly satisfactory recipe in the feed grains and in livestock. As a matter of fact, there are a great many of us that believe we don't need much of a pattern of legislative structure in the livestock industry if we can keep from having unwise programs and unsound programs (in terms of today's necessities) in some other commodities, from upsetting us.

Senator SPARKMAN. That signal is a rollcall, in fact, we will have a series of rollcalls, so I may not come back and I will not be able to stay for the answer to this question. But here is one that puzzles me, Mr. Hamilton. If I remember correctly this is one of the provisions that Mr. Benson has announced will be the administration's farm program, No. 1 in your suggestion of the wheat policy: "Eliminate all acreage allotments and marketing quotas effective with the 1961 crop of wheat."

As I say, I am not going to stay to hear your discussion but I will read the transcript. I just don't see how we can navigate on that kind of a program. Maybe the others do but I don't. I know what Mr. Newsom says about livestock, you don't need much of a pattern. It seems to me that would be taking the pattern out of wheat. It is my understanding that wheat is our most troublesome commodity right now. That is the thing that we have the biggest surplus in and mounting surplus, and the one that is costing us most of the money that we are having to pay out. So if we turn loose both acreage and marketing, I just don't see how it is going to work.

I would like to stay and hear your discussion but I will read the transcript. I would like for all three to comment. I am sorry I didn't have a chance to propound the question to Mr. McDonald but I would like to see all three comment on it.

Mr. HAMILTON. I am sorry the Congressman has to leave. I would like to point out that I read four points and at the end I said that these four points are tied together. Eliminating acreage allotments and marketing quotas is one. At the same time we are proposing that the price support on wheat be based on the price support level for corn with an adjustment for feeding value; and, primarily as a reassurance to the corn farmers, we are also saying this should not be less than 120 percent of the support price for corn in the first year.

In the part of the statement that was not read we gave an illustration showing that if the support price for corn should be $1.08, which is a pretty good guess as to what it will be this year, it would be $1.30 for wheat. This would permit surplus wheat that might be produced to be fed.

We are also suggesting that present Commodity Credit Corporation stocks be held off the domestic market and also the export market except for a limited use under Public Law 480. This means that these stocks would have to be liquidated over a considerable period of time. It would mean that most of our exports and all of the domestic demand for milling wheat and for feed would be supplied from current production, so the farmers would have the current market including most exports for current production. Then we have proposed an expansion of the soil bank. We have proposed a very modest expansion, which is explained here on page 9, to become effective regardless of whether or not our recommendations on wheat are adopted. But we have said also that, if our recommendations for taking acreage allotments off wheat and reducing the support level are adopted, we would then favor boosting the soil bank to a total of 60 million acres.

If you lower the support on wheat as drastically as we are proposing, you are going to get land into the conservation reserve, assuming that an expanded program is available, at a much lower price than you would be able to get it under current conditions where you have to compete with a rather attractive wheat price.

Some of this conservation reserve acreage would come out of the traditional wheat area where some of the land is marginal. Some of it would also come out of the areas where there are 15-acre plots that have been brought into wheat under the quota exemption and where some people might not want to continue in wheat with a lower support price. If such growers could put wheatland in the soil bank, that would be an alternative to going into other feed grains. We think that with this entire package you would get some increase in wheat production in the areas that have the greatest comparative advantage for wheat. You would get some reduction in areas where they are growing wheat on irrigated land, and in humid areas where there are good alternatives. You would get a substantial increase in the use of wheat as feed. We don't feel that this program would cause any great difficulties at all.

Starting from where we are, it would take a few years to solve all our problems. But we think this program would work.

Representative PATMAN. Would you gentlemen like to comment now or would you prefer to wait and do it with the record?

Mr. NEWSOM. I would like to do it now, Mr. Chairman, if I may.

Representative PATMAN. You may proceed.

Mr. NEWSOM. This is a bit of a recast of a story that we were involved in yesterday before the Senate Committee on Agriculture and Forestry. I would say that in the face of the fact that farm organizations have been reputedly unable too often to get together on anything, there are areas in which we do agree. We have long advocated that the support price as we now know support prices (namely, the practice of having the Government guarantee to buy what the market does not absorb at or above a fixed price, or to make nonrecourse loans,

which is about the same as buying it) should be tied so far as wheat is concerned to the secondary use of wheat, which is feed utilization; but that as we do this, in order to get away from some of the evil effects of the present kind of program, we must recognize that we can not afford to reduce farm income accordingly under present circumstances. This is even more true now that it was in 1952 or 1953 when we recognized we would have had a great deal better opportunity to make this kind of change in the farm program with respect to wheat, which is what we are talking about now.

To offset this loss in farm income, we have to part company with our friend of the American Farm Bureau because we would propose an additional mechanism which we call a wheat certificate, which would be issued and in exercise of congressional prerogative provided in the Constitution in the matter of regulating commerce.

The certificate then would be issued in proportion to that wheat—that pro rata share, or each producer's portion of the domestic human food market. Before wheat could be processed for the American human food market, it would be necessary for such processor to purchase the certificate, the funds from which would provide the payment to the producer. This is the type of thing that I alluded to a moment ago when I said we believe it is far less inflationary and far sounder and far more in keeping with an American capitalistic philosophy, to have mechanisms, even though they may be artificial mechanisms to get the necessary level of income from the users or consumers of the commodity, even though as I said a moment ago, some folks prefer to call this a bread tax, presumably to discredit it. We believe that this is much less inflationary, should be more acceptable to all Americans if accurately understood than is the present kind of approach of paying something relatively close to an American price level for the whole production and then subsidize its export or its secondary use into nonhuman food markets, so that in effect one consumer and taxpayer are paying not only on the whole production but also paying storage costs and that other sort of thing.

This is a specific illustration of how we believe that the very philosophy of regulating marketing which is carried out very simply in the case of some commodities that are original in their area so that you can make a normal simple marketing approach work.

I believe this is an illustration of how we might be able to carry out the same philosophy even with respect to a commodity of which we normally export a very substantial portion and put another substantial portion under normal circumstances into what we call secondary uses such as feed or industrial use.

Representative PATMAN. Go ahead, Mr. Curtis.

Representative CURTIS. I am just following through for Senator Sparkman. I think, Mr. McDonald, you want to comment.

Mr. McDONALD. Mr. Chairman, I would like to presume on the committee to make one or two general comments because we find it hard to work out an intelligent plan for any part of the economy unless a quick look is taken at the other part of the economy. We feel there is a relationship between industry and agriculture.

Representative CURTIS. You are talking about Senator Sparkman's question because I had some other questions. I simply want to get Senator Sparkman's question answered.

Did you want to comment on that?

Mr. McDONALD. I want to comment on Senator Sparkman's question. I am just leading up to it, if I may.

Representative CURTIS. Certainly.

Mr. McDONALD. The preliminary before we talk about anything, wool or sugar or the so-called successful programs, is to bear in mind that two-thirds of the American economy is price administered.

Representative CURTIS. That is your opinion.

Representative PATMAN. What was that?

Mr. McDONALD. Let me be more specific.

Representative CURTIS. At least that is your premise. I can see we lose each other immedately if you start like that.

Mr. McDONALD. I think that steel products and prices, an eminent economist, Dr. Gardner Means, has testified before the Congress about this matter many times——

Representative CURTIS. And many other equally eminent economists have disagreed with him. You and I part company immediately from there, but go ahead with your theory.

Mr. McDONALD. We farmers are paying in regard to barbed wire 188-odd as compared to an index of 95 on our farm products. I want to touch on this lightly that the prices of things that farmers buy have doubled. I think it is important in any consideration of a plan to indicate that farm prices are 85 percent of what they were in 1947–49 according to Bureau of Labor Statistics, on the average. In other words, there is a disparity there. We of the Farmers Union feel that some plan should be worked out so as to give the farmer a better position in the economy.

In regard to my second point as to Senator Sparkman's comment on past programs which he indicated he worked on since 1937, we feel that many of these programs have worked very well in past years, and did take into account that a plan must be worked out which would give the expectation of production of acreage, and a rough projection into the future and laid down a program on that basis.

I think it is just as important now as it was then. I think when you work out a program for wheat or corn, that you should consider how much wheat or corn we need. Are we producing one-third too much or one-fourth too much or what have you. This is not a novelty because as I mentioned, the Congress did pass a law, the wheat bill last year, cutting production 25 percent. It seemed to us that this was a logical thing to do when you have too much of something.

Representative CURTIS. The bill does not cut anything. That was the hope. Whether it would have cut it is the issue.

Mr. McDONALD. It cut the acreage.

Representative CURTIS. That is what it claimed it was doing. Sure in our acreage control we claim we are cutting it but we find it is very difficult to just write laws and then have the economic events come about as we anticipate.

You get the point I am making. Surely that was the objective of it. The argument of those who disagreed with it was that it wouldn't do it.

Mr. McDONALD. We have the beautiful example of corn where they turned everything loose.

Representative CURTIS. You heard what Mr. Hamilton said about that. He suggested that this was an unusual weather situation. Was it or was it not? I don't know.

Mr. HAMILTON. Some other things, too.

Mr. McDONALD. It always seems to be an unusual situation.

Representative CURTIS. As a matter of fact, was it?

Mr. McDONALD. Mr. Benson let the farmers produce all the corn they wanted and supported it.

Representative CURTIS. I understand.

Mr. McDONALD. Now we have the corn problem. We are going to have the wheat problem, I expect, if we turn wheat loose.

Representative CURTIS. Let us try to discuss intelligently this matter. Is it true that the weather for corn was unusually good in comparison to other years?

Mr. McDONALD. Yes, sir; weather was good.

Representative CURTIS. How much of a factor did it play in this surplus? But for the program would it have been more with the weather?

Mr. McDONALD. I do know there was a tremendous increase in the acreage put in corn last year.

Representative CURTIS. That combined with the weather possibly.

Mr. McDONALD. Yes, and combined with the bait of a support price when you put your whole farm in corn and get a guaranteed price.

Representative CURTIS. I am not necessarily arguing that the program is good. I want to discuss it in light of what were the facts. In other words, if it were something outside the legislation like weather, we should consider it. If it were other things we ought to consider that. It still could be as you allege that it was the legislation itself that did it.

I would like to make one comment, if I may, Mr. Chairman, which is really an answer to Senator Sparkman's question. One thing is to call attention to the committee's study under Senator Sparkman of 2 or 3 years ago which in my judgment was excellent and got some of these problems out in the open. I regret to say as a Member of the House I have heard very little reference to the facts as best we could get them out in the open on the farm program discussed either by the Agriculture Committee or on the floor of the House what I read of the debate in the Senate.

I certainly thought both Mr. Hamilton's and Mr. Newsom's papers were discussing it from the standpoint of these facts that we do know. I am convinced the more we go along that way the more we are apt to come to some corect conclusions on an extremely difficult problem.

The one thing that the committee study started on, and it was almost a premise, was a separation of two problems. One is the problem of what we could call commercial farming, and it has its problem. The other, and I think you singled it out, Mr. Newsom, the rural population that is interwoven with the commercial farm.

In fact, commercial farming is the main income in the rural areas. I felt that trying to solve the second problem by trying to meet the problems of the first was going to produce a solution to neither. Likewise I think that even solving the first is not really going to solve the problems of the second.

Let me make this one other statement: It does seem to me that the problems of commercial agriculture are less acute than those of the

second, the problem of our rural population. The great technological revolution in farming has produced in its wake many, many displaced skills. For example, the small farmer who can't compete in this thing. There is the problem that to me is the most crying and the one to which I don't know the solution.

Mr. NEWSOM. Your comment, along with the comment, I believe, of Senator Sparkman awhile ago, that made reference to previous attempts to approach solution to this thing, prompts me to want to use this illustration of how the situations do change from time to time and they are almost certain to change in the immediate future even more. This confusion of the two problems in rural areas to which you now refer prompts me to want the members of this committee to know about a recent study that was made in the Hudson River Valley of New York, wherein a larger dairy operation for some reason or other—I don't believe I recall all of the circumstances—lost its agricurtural exemption from wage-and-hour regulation. The thing that I want to point out is that in a rather deliberate, though sometimes I think unconscious, attempt to try to preserve a low price structure for raw materials, including agricultural products in this country, we have from time to time asked the Congress, and the Congress has often responded, in the matter of providing that agricultural labor and agricultural transportation and certain other factors shall be "exempt" from cost-raising law and regulation. There has been good reason for that request and good reason for that action. But as we see the evolution of a larger and larger agricultural structure, I think some of us, rough as it may be for the moment, may have to begin to take a hard look at where this agricultural "exemption" under present circumstances may have to stop.

This illustration in the Hudson River Valley underscores what we have begun to have to think about. When this 600-cow operation found that they had to comply for one reason or another with the provisions under the Fair Labor Standards Act they found that they were no longer able to sell milk at the prevailing price level. It was going to require another 80 cents per hundred to break even on their operation.

That dairy operation disappeared. I am beginning to wonder whether or not we have had quite as much justification—this is a rather painful admission but I think it is entirely an honest admission—recently for our opposition to Secretary Mitchell's movement in this field of agricultural labor. Because maybe we are unwittingly using that exemption to inflict a low wage standard and a low income level on the very farm family operation that all of us are interested in, and some of us emphasize more than others.

Representative CURTIS. It is certainly an interesting observation.

Mr. NEWSOM. This is one that confronts us pretty rapidly. I think we have to continue to insist on preservation of these exemptions because of the limited ability of agricultural income to pay any higher rate at the present time. But we must begin to look farther than that.

Mr. HAMILTON. I have one or two comments that I think ought to be made.

Reference was made to Mr. Benson's action on the corn program, and I would like to remind the committee that Congress set up a

referendum in which farmers were given a choice. Whether the corn program is right or wrong, the fact remains that a heavy percentage of the corn farmers voted for the program which eliminated acreage allotments.

In addition to the weather last year, which I definitely think was a factor, it will be remembered that we had the acreage reserve program—which paid a rather high rate for the retirement of allotted acres—and that it held 6.7 million acres out of corn in the 1958 season. That acreage was all released in 1959, because Congress did not see fit to provide the money to continue the program. This factor alone is sufficient to account for a considerable part of the increase in production last year. Then you may also recall that the Secretary reduced the support prices on barley, oats, grain sorghums and soybeans, all of which compete with corn for acreage. If you take the acreage released from the acreage reserve and the acreage shifted over to corn from the crops where supports were lowered, this accounts for the increase in corn acreage.

Representative CURTIS. Then there probably was a concomitant decrease in those other groups. Was there?

Mr. HAMILTON. There was a decrease over what there otherwise would have been.

In the case of others, there was a large decrease in production. That again was partly weather. The interesting thing, though, is that prices of some of these crops, soybeans and others particularly, have been above support levels. In fact, they have been higher this year than they were a year ago when the supports were lower. You should now get some swing back in acreage this coming year. I understand that hay prices have been higher this year. Perhaps we took out too much hay land this year.

May I make one comment on my difference with Mr. Newsom in regard to wheat. He agrees that the part of the wheat that is fed should move at feed prices. But you know the corn farmers are trying to make their living in a feed market which is already pretty well saturated. If a part of the wheat is going to be supported at one price which encourages a higher production than we think you would get at a different price, then this is really unfair to the corn farmer to say to him, "We are going to hold the umbrella over wheat and let them dump their surplus on the market in which you are trying to make a living." The corn farmer may not like it but he really has no sound basis for objecting if the wheat is sold in the feed market for the price that brings forth the production. But if the price that brings forth the production is higher than the price in which it moves in the corn market, then the corn farmer does have a basis for objection.

Representative CURTIS. Thank you.

Representative PATMAN. The time has arrived for another witness to appear. I shall therefore forgo interrogating these gentlemen. You gentlemen have filed interesting statements. The committee appreciates them. It will be helpful to the committee in its consideration of these subjects.

I believe Mr. Houser has a statement to be filed for the record.

(Mr. Houser's prepared paper follows:)

STATEMENT OF T. V. HOUSER, CHAIRMAN, RESEARCH AND POLICY COMMITTEE, COMMITTEE FOR ECONOMIC DEVELOPMENT [1]

I submit this statement in response to your invitation to me, as chairman of CED's Research and Policy Committee, to comment on the 1960 Economic Report of the President. Most of what I say here reflects work done by our committee and I shall at some points refer to published statements in which the views of our committee on particular subjects are officially and fully presented. At some points, however, I shall go beyond published statements of CED's Research and Policy Committee, mainly to draw your attention to questions that, in my view, deserve more consideration in your committee and in public discussion generally. These are chiefly questions on which CED is now working.

My statement is divided into two parts. First it discusses certain specific issues of economic policy raised by the President's Economic Report or in some cases by the recent report of the Joint Economic Committee on Employment, Price Levels, and Growth. Second, it raises some broader questions which are, in my opinion, if not the questions of 1960, certainly the questions of the 1960's. Appended to my statement is a set of charts prepared by the staff of CED to place the record of economic growth in perspective.

I

The budget surplus

The proposed budget surplus for the fiscal year 1961—$4.2 billion in the administrative budget and $5.9 billion in the cash budget—is the keystone of the administration's economic program. It is the main new measure proposed for the promotion of economic growth without inflation. Many of the recommendations of the report are designed to achieve this surplus and others depend upon its achievement.

The recommendation is, of course, that there should be a substantial surplus if high levels of employment and production are maintained. The estimated surplus is to be achieved if the gross national product is $510 billion in 1960. Presumably, with the same tax and expenditure programs the surplus will be larger if the GNP is larger and smaller if the GNP is smaller.

We strongly support the proposal for a substantial budget surplus. We support it mainly as a positive use of budget policy to promote growth. In a period of high and rising economic activity, the desires of individuals, businesses, and local governments to invest will be large. The amount of investment that is actually made will be limited by the total amount of savings available. The Federal budget surplus is part of the available savings—that is, part of the national income not used for consumption. In general, the larger the budget surplus, the larger will be the available savings and, in prosperous times, the higher the rate of investment. The higher the rate of investment the higher will be the rate of economical growth.[2]

A similar proposition is sometimes stated in different terms. It is said that a large budget surplus is desirable because it holds down interest rates. There is some truth in this but it misses the main point and may be misleading. A large budget surplus, by contributing to a large supply of savings, tends to keep interest rates lower than they might otherwise be. But it is the large supply

[1] The Committee for Economic Development is composed of 185 businessmen and educators. Its purpose is to conduct objective economic research, to support and promote economic education, and to formulate and publish recommendations on major economic problems that will contribute to growth and stability in the American economy, higher living standards and increasing opportunities for all Americans, and to strengthening the institutions and the concepts essential to progress in a free society.

[2] In its March 1959 policy statement "The Budget and Economic Growth," the Research and Policy Committee of CED said (p. 15):

"We believe that it should be the basic policy of the Federal Government not only to balance the cash budget but also to run a substantial cash surplus at high employment. This would greatly assist in the task of conducting anti-inflationary monetary and debt management policies. Equally important, a cash surplus would make saving available for financing private investment that would promote growth. When the Government retires debt, the funds received by bondholders in exchange for their bonds are used for other investments. And, under conditions of high employment, they are likely to be invested directly, or indirectly through the purchase of securities, in enterprises seeking funds for expansion. This important link between surpluses at high employment and growth has been overlooked by many people in recent discussions of budgetary policy."

of savings, and the high rate of investment it permits, that are important. Low interest rates that reflect a large flow of savings are a sign of economic health and vigor. Low interest rates resulting from other causes are not.

There is another important reason for a substantial budget surplus in prosperous times. The Nation is now committed, and we believe properly, to a policy that yields large deficits in recessions. If we are to avoid unnecessarily large and expensive growth of the Federal debt in the long run we must follow a symmetrical policy in prosperity. We must reduce the debt when that is not only consistent with high employment but also useful in promoting growth and restraining inflation.

The budgetary policy recommended for fiscal 1961 can be an essential step toward tax reduction in a subsequent year. The normal growth of our economy yields, with the present tax system, a large growth of Federal revenue. If we can continue to hold down the rate of increase of Federal expenditures, as is proposed for fiscal 1961, this growth of revenues will provide both the necessary surpluses in periods of prosperity and the opportunity for tax reduction.

The idea that we should have a balanced budget and some surplus in prosperous times seems to encounter no explicit opposition in the country. But there seems to be no firmly held idea of the desirability of a surplus of any particular size. There is, I think, a tendency to be satisfied if there is some surplus, even if entirely nominal in amount and little determination to achieve any substantial surplus. In this condition, the inevitably unpopular specific decisions on expenditures and revenues needed to achieve the surplus recommended by the President may be evaded.

It is worth noting that the last time we had a substantial budget surplus was fiscal 1956 when there was a cash surplus of $4.5 billion. This was in considerable part an accidental achievement. The President's budget for that year had estimated a cash surplus of only $600 million. The surplus turned out to be $4.5 billion because revenues outran the estimates. In the next year, although revenues increased by $5 billion, expenditures increased even more and the surplus was cut in half.

To say just how big the surplus should be is, of course, extremely difficult. Essentially, the question is how much we are willing to pay for. Some clue may be provided by looking back to 1956 when the cash budget surplus was 1.07 percent of the gross national product (in calendar 1955). The Joint Economic Committee in its recent report has said that we should place greater reliance on fiscal policy and aim for higher budget surpluses during periods of prosperity. In an economy that values growth highly, that is politically sensitive to monetary restraint and that is exposed to inflationary psychology, this recommendation is certainly wise. The $5.9 billion cash budget surplus estimated for fiscal 1961 would be 1.16 percent of the 1960 GNP on which it is based. That is, the percentage would not be significantly larger than in 1956. In these terms the projected budget surplus should be regarded as a minimum goal and not as an invitation to more spending.

In this connection the record of revenues and expenditures since 1956, as shown in the table below, is alarming:

Cash budget

[Billions of dollars]

Fiscal year	Receipts	Payments
1956	77.1	72.6
1957	82.1	80.0
1958	81.9	83.4
1959	81.7	94.8
1960 (budget estimate)	94.8	95.3
1961 (budget estimate)	102.2	96.3

Federal cash receipts increased by an enormous figure, $25.1 billion, from fiscal 1956 to the estimate for fiscal 1961, almost entirely as a result of economic growth and inflation. In the same period, expenditures rose by very nearly the same amount, $23.6 billion. I have no doubt that a substantial increase in expenditures was proper in this period. But I have a serious doubt that so large an increase was necessary. There seems to be an inexorable tendency for expenditures to rise in line with receipts, which cannot be explained by a balanced appraisal of the need for expenditures.

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This tendency does not operate smoothly and continuously. Seventy percent of the expenditure increase of this 5-year period came in two spurts, from 1956 to 1957 and from 1958 to 1959. The increases came when expenditure restraints were relaxed in fiscal 1957 because we were running what seemed a large surplus and in fiscal 1959 because higher expenditures could be rationalized by the need to combat the recession. This pattern supports the view that the increases of expenditures were not dictated by expenditure requirements.

The warning issued by CED's Research and Policy Committee in 1947 describes our present condition. We said:

"The really frightening possibility is that we shall oscillate between adherence to the annual balance principle in prosperity and belief in compensatory spending in depression. This could only mean an endless ascent to higher and higher Government spending, both in prosperity and depression." [3]

We urgently need a more definite and conscious policy for the future behavior of the budget, a policy that is agreed to and understood in the country. This policy should provide for applying part of the future increase of revenues that comes with economic growth to reduction of the debt, part to reduction of taxes and part to necessary expenditure increases. It should include an understanding of the level of surplus at which we will aim in prosperous times and of the policies to be followed in recessions. To carry out such policies we need more systematic procedures in the administration and in the Congress.

The pressures for more spending that constantly arise in the political process are well known and understood although always difficult to contain. We are now witnessing in many quarters the development of an intellectual rationale for these pressures, which throws the cloak of liberalism and high morality around them. We are being told that to express our national purpose, indeed even to have a national purpose, we must increase expenditures in all of the categories into which the national budget is divided. Federal expenditure is considered to have great growth-producing, aesthetic, and spiritual value, whereas private spending is considered to be vulgar, materialistic, and selfish.

This is a completely fallacious view. The national purposes of the United States are the purposes of the American people. The American people express their purposes in their individual behavior and through a number of institutions, including their families, businesses, voluntary associations of all kinds, State and local governments and the Federal Government. There is no general presumption that dispositions of income through the Federal Government are "better" than other dispositions. In fact, if there is any general presumption it surely runs in favor of private uses of income in a liberal society that values individual choice highly.

We in CED's Research and Policy Committee believe that we have earned the right to make this statement by standing ready to examine particular purposes and amounts of Federal expenditure on their merits. We have supported large or increased Federal expenditure where we thought it important, as in the cases of national defense, foreign economic assistance and aid to education. We have constantly emphasized that the essence of the question of Federal spending is selectivity. Therefore we are free to say that the growing idolatry of Federal spending is as misguided as the older blind opposition to all Federal spending.

The interest rate ceiling

We support the President's recommendation for repeal of the existing ceiling of 4¼ percent on the interest rate that may be paid by the Treasury on Federal securities with initial maturities in excess of 5 years.

The situation as I see it is this:

1. It is desirable that the Treasury should from time to time issue securities with maturities in excess of 5 years. If the Treasury never issues any securities with a maturity in excess of 5 years, the average maturity of the debt will gradually decline with the passage of time—just as the average age of a population will gradually rise if no babies are born. A large part of the debt would come due for refunding each year, monetary policy would be impeded and its effectiveness reduced. So far as I know, no one is proposing that the Federal debt should consist entirely of securities maturing in 5 years or less. There may be disagreement about the time to offer longer-term securities, but I see no disagreement on the proposition that they should be sold some time.

[3] Taxes and budget: "A Program for Prosperity in a Free Economy," November 1947, p. 30.

2. At present Federal securities with a maturity in excess of 5 years cannot be sold with interest rates of 4¼ percent. People can buy long-term Federal securities already outstanding at prices that will yield them over 4¼ percent; they are not going to buy them from the Treasury for 4¼ percent. No one can tell how long the situation will last or, if it should pass away, when it would recur. This is simply because no one can confidently foretell the future course of interest rates.

3. The combination of the two foregoing conditions means that it is extremely likely that there will be occasions in which it is desirable to sell securities with maturities in excess of 5 years and when the interest rate ceiling makes it impossible to do so. An archaic law—over 40 years old—will prevent the Government from managing its debt in a rational way.

This, it seems to me, is the minimum case for the removal of the ceiling. It involves no argument other than the desirability sometime of issuing debt with a maturity longer than 5 years and the unpredictability of the future coures of interest rates.

I am not aware of any informed objection to the case for the repeal of the interest rate ceiling. The argument has never been whether the ceiling should be removed but only whether Congress should exact a certain price for aggreeing to remove the ceiling. This is quite clear in the recent report of the majority of the Joint Economic Committee. The report proposes a number of changes in fiscal, monetary, and debt management policies that the majority believes should be made before the interest ceiling is repealed. There is no claim that the desirability of removing the ceiling depends upon these other changes being effected. It is only maintained that these other changes are themselves desirable and that the interest-ceiling issue can be used as a lever to pry them into effect. As the report says, "It may well be that only by refusing to remove the ceiling can these major reforms be brought about."

In other words, the committee recommends that no action be taken on a desirable, simple, and logically self-contained proposition until action is achieved on a long list of complicated, technical, debatable and, in some cases, highly unlikely measures. The history of logrolling, riders, and filibusters in our political affairs is too long for any one any longer to be shocked by this kind of thing. But one must express regret at finding it done by the committee set up to improve economic understanding in the Congress and in the country.

Adequate discussion of the package of changes recommended by the committee as the condition for removing the interest rate ceiling would exceed the proper bounds of this paper. However, the proposals may be briefly categorized as follows:

1. A number of technical changes, including the sale of long-term securities at auction, the issue of callable bonds, imposition of margin requirements, change in the bond-dealership arrangements and change in the present system by which the Treasury obtains advice. Whether these changes, taken all together, would increase or decrease the cost to the Treasury is uncertain. The net effect, in whatever direction, would probably be small. A Treasury security is a well-known, uniform product, bought and sold by experts in a highly organized market. Changes in the merchandising methods are unlikely to affect the price much.

2. Providing large surpluses in times of prosperity and making "necessary tax and expenditure reforms" to provide such a surplus. The recommendation for surpluses is commendable. The expenditure reforms—presumably reductions—to help achieve the surpluses are not specified. The tax "reforms" suggested, which may or may not really be forms, have just been studies, along with many other proposals, by the House Ways and Means Committee. The chairman of the committee has announced that there will be no action in this field in 1960.

3. Issuing more long-term debt when interest rates are low. Expert opinion on the merits of this policy is sharply divided. In fact, in the last 6 years almost all the longer term debt issued by the Treasury has been issued in periods of relatively low interest rates. One difficulty with a statutory prescription on this subject is the problem of knowing when rates are "low," since the relevant test is whether the rates are lower than they will subsequently be.

4. Several steps that would increase the proportion of long-term Federal securities relative to short-term securities in the portfolio of the Federal Reserve banks. But as the joint committee report points out, the problem of debt management is the problem of the composition of the publicly held debt—the debt held outside the Federal Government and the Federal Reserve System. To lengthen the debt held by the Federal Reserve would be to shorten the debt held by the public, which is the opposite of the desired result.

5. Providing the reserves needed for the long-run growth of the money supply by Federal Reserve purchase of Government securities rather than by reducing reserve requirements. This would probably tend, if it has any effect, to reduce interest costs to the Treasury somewhat and to raise interest costs and reduce the availability of credit for those borrowers most dependent upon commercial banks, such as small business. Whether this would be a gain is debatable. In any case the effect would probably be small.

6. Using market power of the Government, as the biggest factor in the capital markets, to reduce its interest rates. The argument here is that the Treasury is so large a borrower that the situation approaches what the report calls monopsony—that is a situation in which a sole or dominant buyer can set the price. What this argument overlooks is that the monopsonistic buyer can set the price only if he is willing to adjust his purchases to the amount the market will supply at the price set. The monopsonsit cannot simultaneously determine both the amount he will buy and the price he will pay. The Treasury cannot adjust the amount it will buy (borrow) but must buy (borrow) an amount equal to the securities coming due less the surplus. Therefore the Treasury, despite its large size, does not have "monopsony" power.

Education

We are pleased that the Joint Economic Committee report attaches high importance to education as an element in economic growth. We agree that education is fundamental for growth as well as for other objectives of society, including wiser use of our increasing output and leisure.

The Research and Policy Committee of CED has just completed an extensive study of one important aspect of the educational problem—better financing of public elementary and secondary schools. Copies of our policy statement, "Paying for Better Public Schools" are submitted with this testimony.

The recommendations in this statement are based on the relief that the American people value education, can be brought to value its improvement, and will be willing to pay for it. The record of the postwar years supports this belief. We have greatly increased expenditures for public schools, and appear to have improved our public school system despite the need to accommodate the huge rise in the number of schoolchildren. But our present schools do not meet the standards we should have, can afford, and that the American people would want if informed of all the facts.

The recommendations in our report are designed to strengthen the local school district as an effective unit of government, to raise school systems that fall seriously below average standards to a reasonable level of performance, and to facilitate the improvement of schools in all systems throughout the country. We make four mail recommendations to these ends.

1. *School districts.*—Immediate reorganization of small school systems into effective units of local government is required in most States. A large proportion of our 45,000 school systems are to small to provide good schools at all or any kind of schools efficiently. Moreover, small district organization creates extreme disparities among districts within a State in the per pupil tax base. This is undesirable in itself and greatly complicates State programs of school support. The disadvantage of small districts is generally agreed upon. The question is how to correct the situation.

Our review convinced us that effective consolidation cannot and will not be achieved by the local units themselves through voluntary reorganization, even under rather strong State pressure. Progress is too slow, and the new units formed are themselves frequently much too small. On the other hand, many States have achieved school systems of appropriate size by mandatory State legislation. Twenty-three States have at some time reorganized their school districts in this way. Even though the reorganization plan in a few of these States was not fully adequate, these 23 States together contain fewer school districts with less than 1,200 pupils than do any of 10 individual States that have not relied on voluntary reorganization.

We recommend mandatory action by State governments to create units of school government that can operate effectively and efficiently.

2. *State assistance to local school districts.*—Local school revenues are drawn almost exclusively from the property tax. Districts with adequate economic resources are often unable to tax these resources through the property tax. Increasing the property tax rate will further increase the already excessive burden on real property as compared with other sources of income. The inherent limitations of the property tax, as well as other limitations imposed by State law, are

serious obstacles to the flow of funds into education. We believe that in most States the State governmens, with their broader and more varied tax sources, should take over from the local districts a larger share of the financial burden of the schools.

The way that State funds are allocated to school districts is also of great importance. We recommend that State funds should be distributed to local districts through a foundation program that insures each district within the State the financial ability to support its schools. Such a program equalizes the ability of the local districts to support schools up to the foundation level of support, while leaving each district free to use its own resources to go above the foundation level.

3. *Federal support for education in the poorer States.*—Our analysis indicates that State and local governments can and will obtain the funds needed both to provide for rising enrollments and to increase the resources per pupil provided to the schools. Since we also believe increased Federal participation in school support has important disadvantages, we oppose as unnecessary and unwise, general support of schools on a nationwide basis.

We do find that in a number of States with low per-capita incomes and large numbers of children in school, school expenditures per child in public schools are much below the levels prevailing in the rest of the country. We believe it is not realistic to expect that the poorer States will bring their schools up to nationally acceptable standards out of their own resources. We consider the inferior education that these States can provide to be a source of weakness and concern to the entire Nation. We recommend that the Federal Government make financial grants amounting to about $600 million a year to support public schools in those States where income per public schoolchild is substantially below the national average. We believe that this expenditure would make a greater contribution to the growth of the American economy and to the quality of American life than many other expenditures in the budget. This recommended expenditure therefore can, and should, be accommodated in the budget without reducing the prospective surplus.

4. *Citizen effort to improve the schools.*—Reforms such as we have suggested will have to be brought about by the efforts of citizens who want better schools. Moreover, improvements in school organizations and financial arrangements will permit better schools, but the actual quality of each local system will necessarily depend on its own citizens.

The numerous ciitzens throughout the country who appreciate the need for improved education must be better organized at every level of government. This is the way to generate the energy necessary for results. Our report describes types of organization that have been successful in gaining better schools.

The balance of international payments

The 1960 Economic Report of the President is, I believe, the first to give prominent attention to the question of the U.S. balance of payments. This is, of course, a reflection of the marked change that has occurred in the world economic situation.

CED's Research and Policy Committee has just completed and will shortly issue a statement on the U.S. balance of payments problem. Our findings agree in general with the views presented in the Economic Report. Since our statement will soon be available I shall touch here on only a few aspects of the question.

Balance of payments deficits of the magnitude experienced by the United States in 1958 and 1959 cannot be allowed to continue. There are indications that the deficit will decline in 1960, but there are no reliable indications that the problem is going to disappear by itself.

The United States is in a strong economic and financial position. We face no immediate danger. But we must use the time and opportunity given us by our strong position to select the best ways to reduce the deficit.

We must use methods to correct the deficit that are consistent with our major financial objectives. These objectives include maintenance of high employment, price stability, and economic growth at home, continued U.S. contribution to the military strength of the West and to economic progress in the underdeveloped world, and leadership by the United States in moving toward a freer international trading system.

The first plank in a program for balance of payments equilibrium must be a strong domestic anti-inflationary program. The debate over whether we are "pricing ourselves out of world markets" is so far inconclusive, mainly because it is difficult to frame the question in a meaningful way. Clearly we have con-

tinued to make large exports. Equally clearly we have not exported enough to prevent an excessively large balance of payments deficit. Whatever role may be assigned to past inflation, stopping inflation will help our future balance of payments position and resuming inflation will hurt it.

The instruments for preventing inflation lie mainly in the fields of fiscal, monetary, and debt management policy. A large budget surplus in periods of prosperity, which I have already discussed, will obviously make a major contribution. So will an adequately restrictive monetary policy. This increases the importance of repealing the interest rate ceiling, which has a close symbolic and actual bearing upon our ability to follow an anti-inflationary course.

It is sometimes maintained that a stabilized average level of prices and high employment are incompatible in the United States and that, therefore, it should be our policy to accept a gradual inflation in order to maintain high employment. We have indicated in an earlier statement[4] our belief that the incompatibility has not been proved and, more important, that if the incompatibility does exist the proposed solution—gradual inflation—will not solve the problem. Consideration of our balance of payments position is further evidence of the impossibility of accepting the inflation solution.

II

I should like to raise some points that are suggested by reading the Economic Report of the President and the report of the Joint Economic Committee on Employment, Growth, and Price Levels. These points have to do less with immediate and specific policy issues than with the philosophy and attitudes that underlie the approach to policy in general. My objective is to raise questions that, in my opinion, need discussion, and I offer the point of view I am expressing as a means for stimulating discussion.

The change in our conception of our economic problems since the time of the debate over and enactment of the Employment Act in 1946 is striking. A simple conception underlies the Employment Act. There was a national objective—maximum employment—that could be statistically defined and measured. There was a certain given economic system the main characteristics of which were known. There was a small number of policy instruments that could be applied to this system to make it yield the objective. Some language in the act tended to qualify this simple view, but the operational significance of this qualification seemed to be small. Essentially the act envisaged the short-run manipulation of the given system to yield an agreed, measurable result.

For such a purpose the device of the annual Economic Report of the President, with annual hearings and a report thereon by the Joint Economic Committee, was appropriate. The President would report how close we had come to the target in the preceding year; he would forecast how close we were likely to come in the next year; he would recommend some combination of measures to hit the target in the next year. The Joint Economic Committee would, in its turn, give the Nation the benefit of its judgment of the economic record of the preceding year, and make its own recommendations.

It seems to me that our present position and conception is different from what it was in 1946, and that the change that has taken place is not as fully recognized as it might be in administrative and congressional operations under the Employment Act.

One basic change is that we are conscious of and concerned about more economic goals than we were in 1946. The first addition was price level stability—at least in the understanding of the Employment Act, although not in its language. Later, growth, efficiency, and good use of the Nation's resources and output came into the front line of conscious objectives.

The multiplication of objectives complicates the problem, because it multiplies the possibilities of conflict among the objectives. A more serious difficulty, however, is that such objectives as growth and good use of resources may be qualitatively different from the employment objective. Their specific content is less certain and may be impossible to describe.

At the same time the fundamental nature of the economic system we have or would like to have has become the subject of major disagreement, even though this remains implicit rather than explicit in much discussion.

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[4] "Defense Against Inflation—Policies for Price Stability in a Growing Economy," a statement of national policy by the research and policy committee of CED, 1958.

Reading the Economic Report of the President and the majority report of the Joint Economic Committee one is struck by the extent to which the differences between them result from differences of view on what the economic system is like and should be like and what we should expect of it. But here, as in most other discussions, these underlying differences are not explicitly stated.

The point about the different qualitative nature of our objectives can perhaps be illustrated by contrasting the employment objective with the growth objective In a rough and ready way we can define what we mean by "full" or "high" or "maximum" or "optimum" employment. Probably few people would deny that it lies in the range of employment of 95 to 98 percent of the labor force—which is a small range. But we are unable to say whether the optimum rate of growth is 3 percent or 6 percent per annum—which is a range of 100 percent, or something larger.

The reason for the difference in ability to specify the employment goal and the growth goal goes back to the nature of the choices upon which each rests. The employment goal is, as it seems to me, that those people who have chosen to work, at the terms of choice possible in the real world, should be free to do so. The labor force is the number of people who have made this choice. The measurement may be more or less good, but the idea seems clear. When we say that our goal is employment of, say, 96 percent of the labor force, we mean, I think, that, subject to inevitable imperfections, those who have chosen to work should have the opportunity to do so.

The specification of a national growth objective has no such rock of individual choice to rest upon. The choices of individuals do, indeed, affect and largely determine the rate of growth. One could define the national growth objective as the rate of growth that would result from these individual choices, just as we define the employment objective in terms of the number of individuals who choose to work. But it would be difficult, and, possibly, not very useful, to try to assign a number to this growth objective.

The minority report of the Joint Economic Committee adopts the first of these concepts of the growth objective quite explicitly:

"The appropriate goal on growth is that we should be able to meet our collective needs and responsibilities and to provide the fullest opportunity for each individual to devote whatever share of his disposable income he wishes to providing for his future well-being, and for that of his children and descendants. The outcome of such choices by individuals will be a certain longrun average rate of change in total production. There is no basis for saying that either a higher or a lower rate of growth than this would be superior or desirable. Our policy toward growth should simply be that these opportuntities should be kept open in such a way that the choices made can be based on the real facts of our productivity."

I interpret the basic philosophy underlying the Economic Report of the President as being rather close to this, although it is not explicit on the subject.

The alternative is to make a national choice of a growth objective independent of and different from the sum of the individual choices. This, it seems, is what we are now being urged to do. However, the basis on which we would make the national choice, once we get away from the individual choices, is difficult to see.

The majority report of the Joint Economic Committee seems to lean toward the specification of an independent national goal for growth, or at least to the appraisal of the performance of the economy in terms of such a goal.

Whichever of these views of the national growth objective is accepted, the Federal Government will have positive responsibilities with respect to growth. The difference, as I see it, between these views is not between a negative and an affirmative Federal policy. The difference is between trying to help make individual choices effective and trying to superimpose another choice on the individual choices.

Whether or not we should specify a national goal for growth is an exceedingly difficult question, and my purpose here is not to suggest an answer to it. As I said at the beginning of this section of my testimony, my objective is more modest: to point out difficulties that arise in our discussion of policy when we do not state clearly enough the assumptions from which we proceed.

The issue of the growth objective is an aspect of another one. To what extent, and in what areas, can we wisely specify objectives of the economic system different from the results that the system will spontaneously yield when the system works well according to its own nature?

This raises the basic question about the nature of the system.

We can approach this question by starting with a "standard" description of the American economy, such as was contained in an early statement of CED's Research and Policy Committee:[5]

"In a free society people organize to serve their purposes in a way that maximizes individual freedom and minimizes concentration of power. There must be such a division of responsibilities among persons and institutions that the purposes of the members of the society are efficiently served without a centralization of authority that jeopardizes individual liberty.

"Among the ways in which the people of a free society organize to serve their economic purposes are:

"(1) The process of voluntary exchange of goods and services among competing individuals and businesses—technically known as the market. The term 'market' does not refer only to such highly organized mechanisms as the stock market or the grain exchanges. It includes all the channels through which people buy from and sell to each other.

"(2) The Government.

"(3) Voluntary associations organized to serve the common interests of their members on a basis other than exchange among the members. This includes corporations, unions, trade associations, farm organizations, etc. The individual decisions of some of these organizations, because of their size or leadership, have important consequences for the economy as a whole.

"The market is the key economic institution of a free society. The allocation of resources among productive uses and the distribution of the product emerge as the result of millions of free individual choices in the market.

"The market process of voluntary exchange makes two great contributions to the organization of the society.

"First, despite all imperfections, the market operates with an efficiency not equalled by any other system. Decisions are made at each point throughout the economic system by persons most closely concerned and generally best informed about the alternatives in each particular situation. But at the same time the decisions are not made in isolation. Each person has before him the relative prices of various goods and services which represent to him the conditions under which these products can be supplied and the demands of other purchasers for these same products.

"Second, the decentralization of decisionmaking in the market permits society to be organized without great concentration of power and without coercion. Each individual makes his own voluntary adaptation to his economic environment; he is not coerced into it by a central decisionmaker.

"The function performed by the market is to determine how much of each particular commodity or service is produced, by whom, and for whose benefit. These questions cannot be left to government in a society that values freedom. They are too complex to be efficiently handled by an administrative agency. Moreover, any government entrusted with making these decisions would have tremendous power over the lives of its citizens."

We are all aware that our system does not work perfectly as described. But I think that we are all agreed that the central question is whether it works well enough "for all practical purposes" so that we need not have resort to alternative devices that are surely inferior in principle.

A question is now being raised about the realism of this description in connection with the analysis of inflation. It is being said that markets for commodities and labor are so imperfect, that business and labor organizations have so much power, that without voluntary or imposed restraints high employment and price stability will be incompatible.

This is a serious charge and its implications go far beyond the inflation problem. If the market power of business and labor organizations is so strong and so widespread as to cause inflation in the face of monetary and fiscal restraint, then this market power is probably also harmful to the efficiency, growth, and equity of the system.

The remedies being proposed for this malady are so far of a tentative and intermediate character. But I have no doubt that if the diagnosis is generally accepted we will be exposed to stronger "remedies", including price and wage controls which no well-informed person now wants.

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[5] "Monetary and Fiscal Policy for Greater Economic Stability," a statement of national policy by the Research and Policy Committee of CED, 1948.

The belief is becoming widespread that our economic system is now infected with a degree of market power—of labor or business or both—that makes the standard description of the free system inapplicable. Traces of this can be found in the Economic Report of the President and much more in the majority report of the Joint Economic Committee. Yet the hard evidence on this subject, so far as I know it, is inconclusive.

I suggest that this is a subject on which conclusions should be reached only on the basis of the most careful weighing of the evidence. Even then, the conclusion that the competitive model does not work should be reached with great reluctance. Yet I fear that conclusions are being reached from fragmentary observations and without appreciation of their consequences.

In this connection I would like to commend the Joint Economic Committee for the study papers and staff report of its project on employment, growth, and price levels. There is much in the material with which I would disagree, and certainly they do not end the matter. But they state the facts and arguments behind certain points of view more clearly than has been done before and thus contribute to the level of the continuing discussion.

Please allow me to repeat that my purpose in making these remarks to the Joint Economic Committee in hearings on the Economic Report of the President is to urge more explicit and rigorous statement of both the assumptions about national objectives and the economic system that underlie policy recommendations, and the logical implications of the assumptions and recommendations, in the hope that raising these questions may contribute to a clearer discussion of these important subjects.

Both scales of the lefthand chart above are arithmetic, i.e., equal amounts of time or quantity are assigned equal space on the time (horizontal) and the growth (vertical) scales.

The same thing is true of the time scale of the chart at the right. The difference is in the vertical scale. There, as you go up the scale, the distances assigned to each interval (the interval here being 20) become progressively smaller. All of the growth reckoner charts are of this (semilogarithmic) type. They are made this way so that a constant percentage increase will show up as a straight, upward sloping line, and not as a curve.

Such a chart straightens out constant growth (rate of increase) lines by operating on the principle of compound interest. If an economy is to grow at a constant rate, it must grow by ever increasing absolute amounts. That is, it must perform as compound interest performs. When this is charted arithmetically, a constant rate of increase will be a curve, since the line showing the constant rate of increase will have to climb faster all the time, to keep up with the ever increasing absolute amounts of increase. The logarithmic scale reduces space assigned to absolute increases enough to eliminate this effect, letting a line showing a constant rate of increase climb by the same amount all the time. It is therefore a straight line.

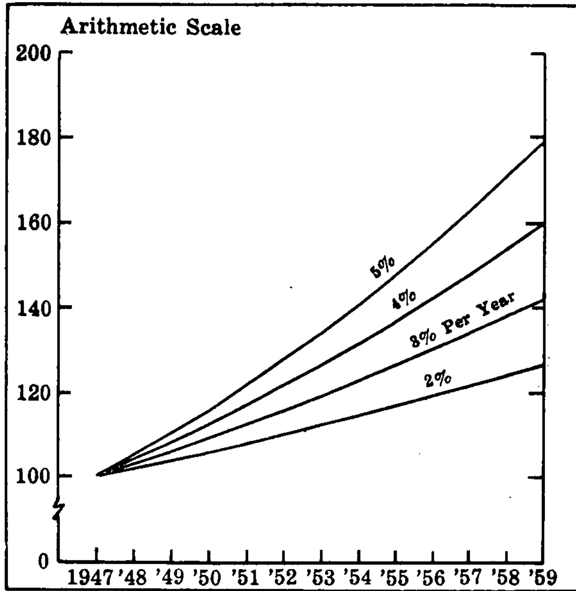
On the above semilogarithmic chart we have sketched in an imaginary growth line, completing it as an illustration of the growth reckoner charts that follow. The rate of growth from 1947 to any other time shown on the chart can be read off simply. If it is right on the 3 percent line, then growth from 1947 to the time in question was 3 percent. If it is, say, midway between the 3 and 4 percent lines, growth from 1947 to the time in question averaged 3½ percent.

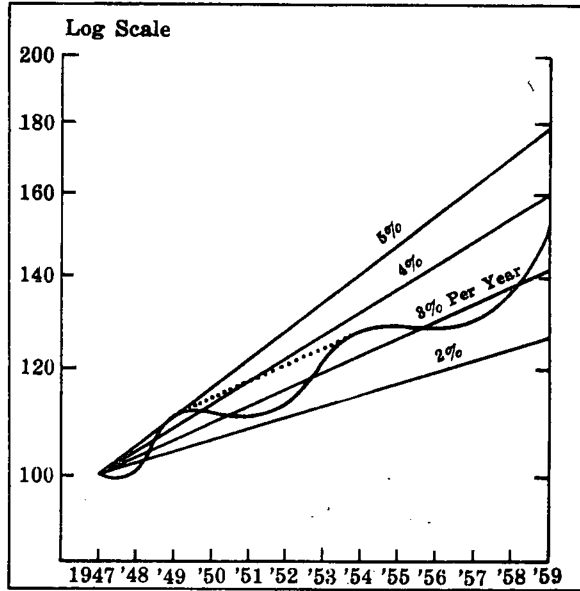
RECKONING POINT-TO-POINT GROWTH

The growth reckoner charts can also be used to find a growth rate from any one to another point on the chart. Simply draw, as we have done above (the dotted line on the right hand chart) a line that takes in the period you want to know about (say, 1949 to 1954). If your new line's slope is most like the slope of the 3 percent line of constant growth, then the rate of growth between the two times you are interested in was about 3 percent, as in our illustration.

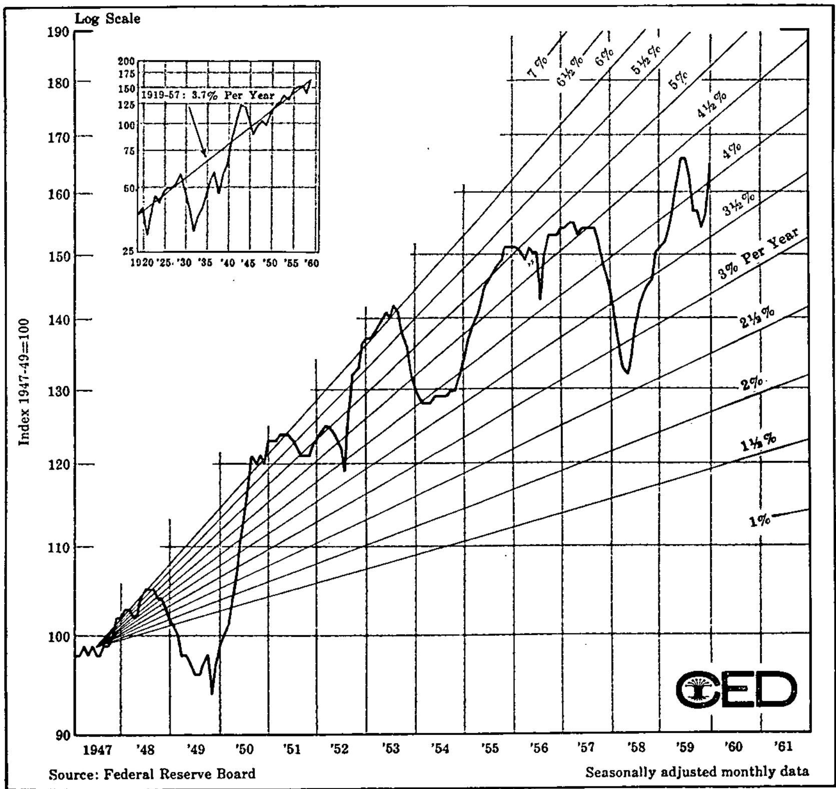
To increase the usefulness of the charts in this respect, we have provided tick marks along the righthand and top borders of the charts, with accompanying percent numbers. A line drawn from the starting point of the chart (the point of the fan over 1947) to a tick marked, say, 1 percent, shows a constant rate of growth of 1 percent.

Straightening Out Economic Growth

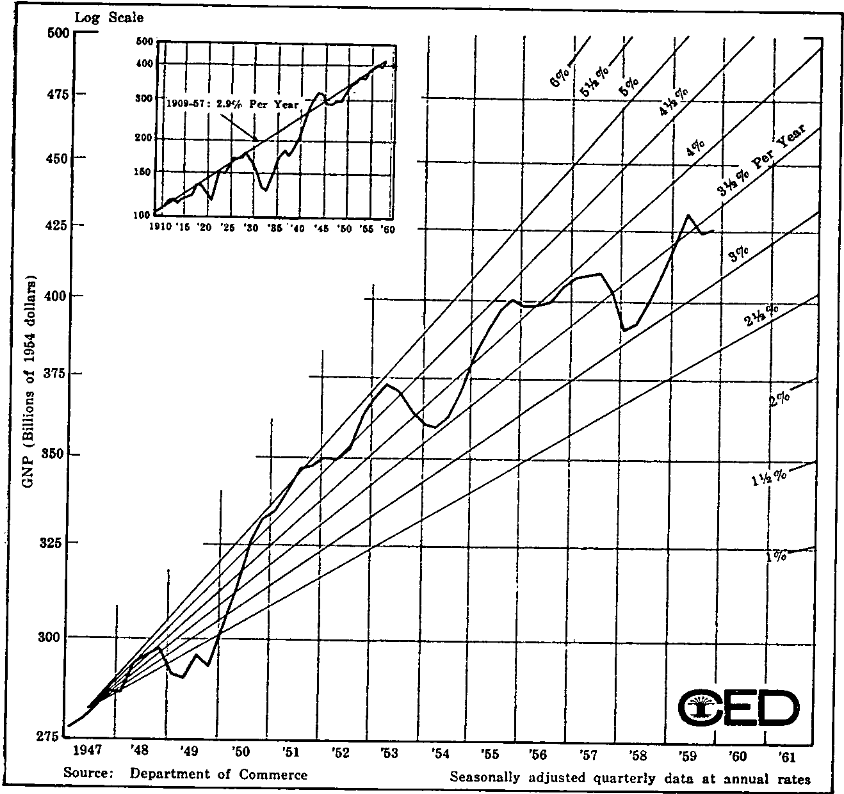




INDUSTRIAL PRODUCTION



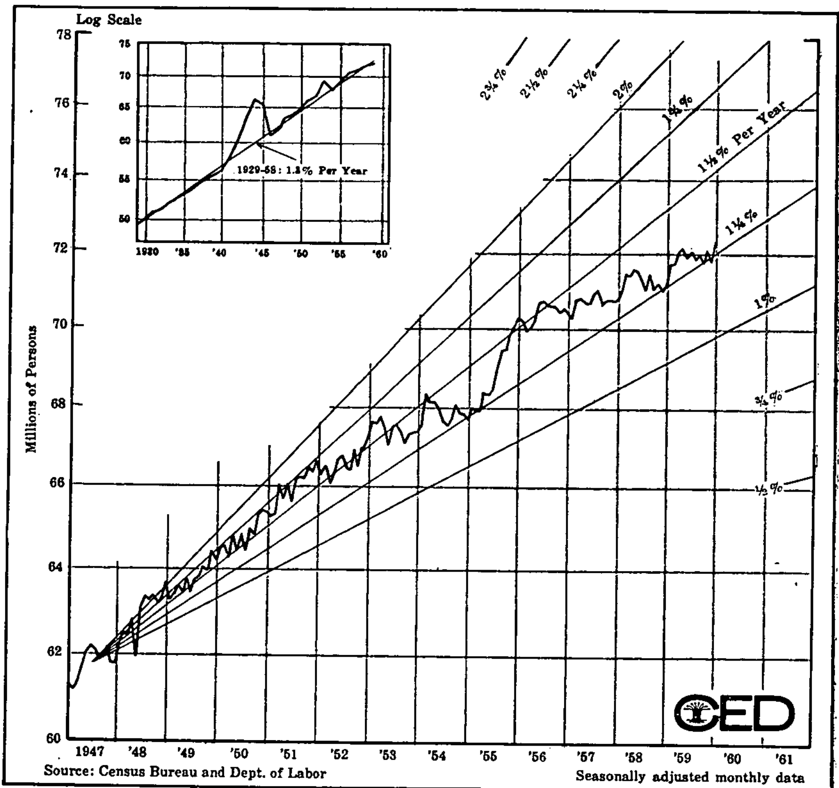
REAL GROSS NATIONAL PRODUCT



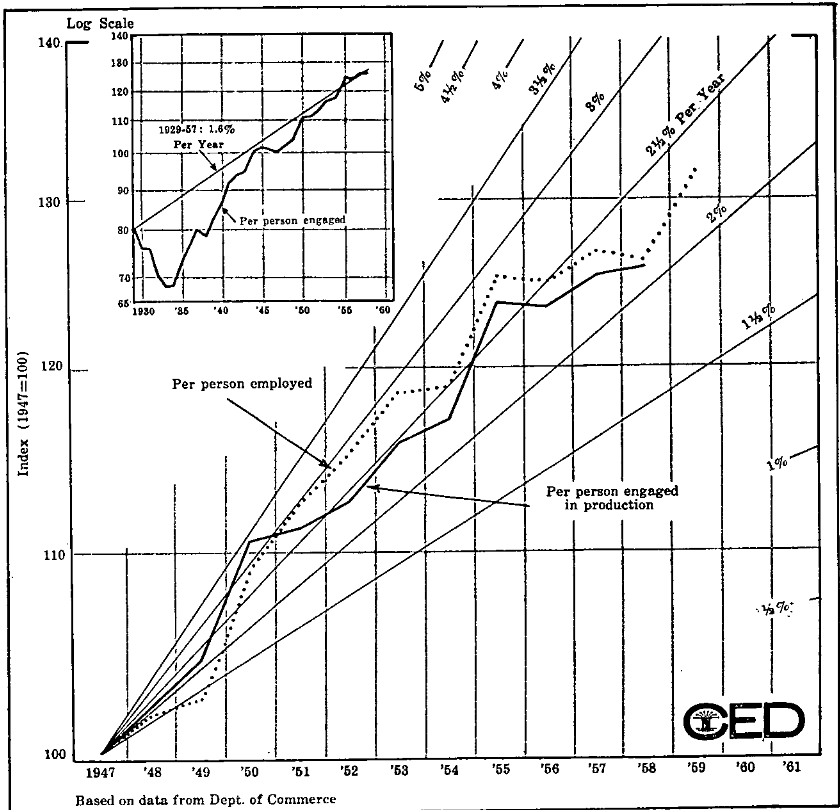
Source: Department of Commerce

Seasonally adjusted quarterly data at annual rates

TOTAL LABOR FORCE

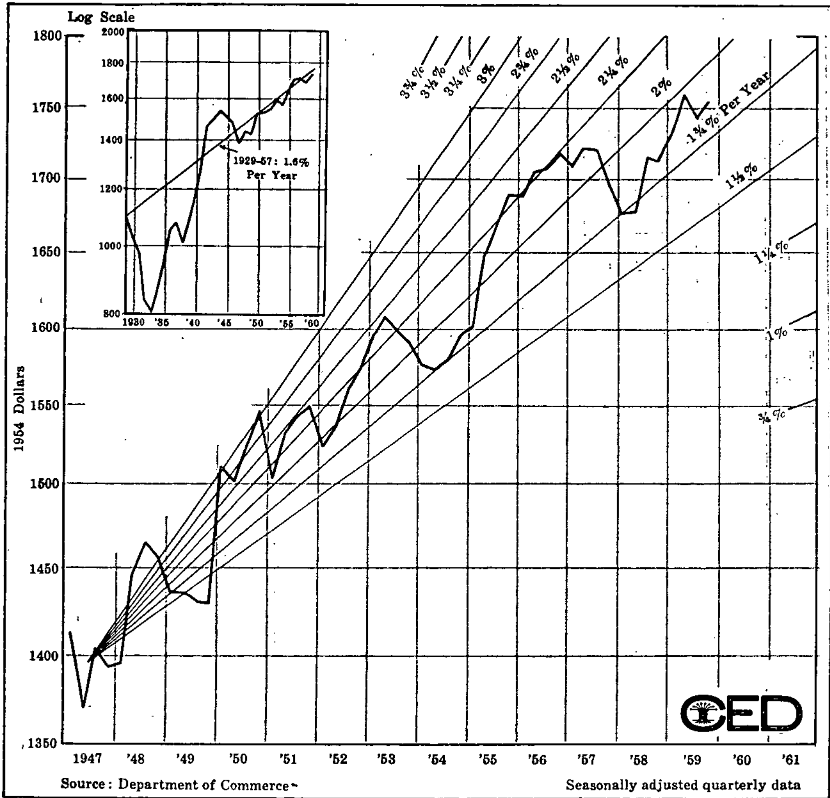


REAL GNP PER PERSON EMPLOYED OR ENGAGED IN PRODUCTION

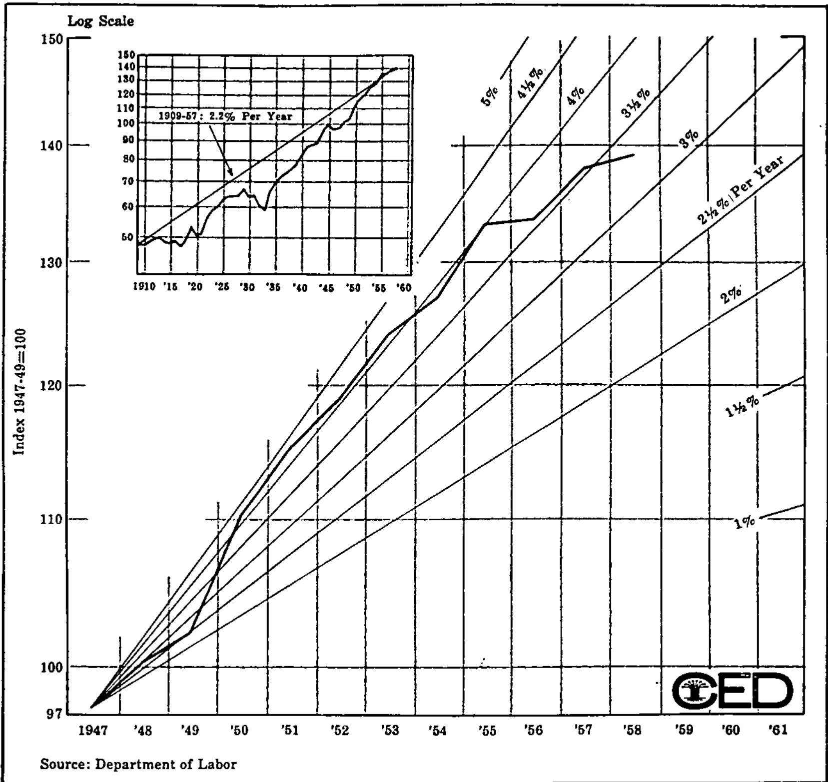


Based on data from Dept. of Commerce

PER CAPITA DISPOSABLE PERSONAL INCOME IN CONSTANT DOLLARS

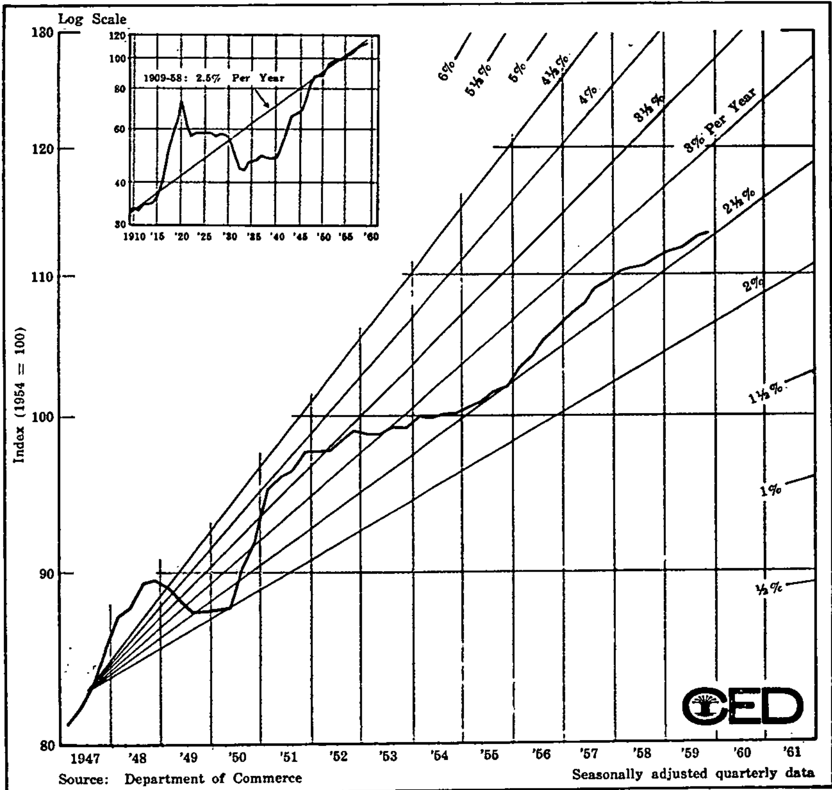


REAL GNP IN THE PRIVATE ECONOMY PER MAN-HOUR WORKED



Source: Department of Labor

PRICES
(GNP Price Deflator)



Representative PATMAN. Mr. Arthur Charous is on the agenda for 3:30 p.m., speaking for the Federal Statistics Users Conference.

Mr. Charous, we are delighted to have you, sir. You may file your statement or you may read your statement, or you may proceed as you desire.

You may proceed.

STATEMENT OF A. ARTHUR CHAROUS, TRUSTEE, FEDERAL STATISTICS USERS' CONFERENCE

Mr. CHAROUS. Mr. Chairman and members of the committee, my name is A. Arthur Charous. I am assistant to the manager of the economic research department of Sears, Roebuck & Co. I appear before you as a trustee of the Federal Statistics Users' Conference, and not as a representative of my employer.

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.

During the past few days you have heard a good many evaluations of the President's Economic Report from a number of different points of view. I am not familiar with the testimony in detail; I have seen only those references which have appeared in the press. Despite the diversity of views reported, one common feature is apparent: every witness who has appeared before you has used Federal statistics as a basic informational source for his analytical argument.

There has been a tremendous growth in the use of Federal statistics over the past few years. In part, this stems from the continuing growth of the economy in size and complexity which has given rise to new needs for information for all kinds of public and private decisionmaking. In part, it comes from wider business use of new concepts of rational decisionmaking. In part, it is due to the very existence of the President's Economic Report and of a Joint Economic Committee which continually draw public attention to significant economic problems of national importance.

This increasing use of Federal statistics has focused attention on the need to improve them. Improvements have been made; others are in the making. And the prospects for further improvements seem better than they were even 5 short years ago. A growing user awareness of the need for better data, renewed efforts in the executive branch to present a systematic program for the improvement of Federal statistics, and a growing congressional appreciation of the importance of Federal statistical information have all contributed to the improvements which have been made.

Although Federal statistics today are better than they were some years ago, they will have to be improved at a more rapid rate than in the past if they are to meet the needs of a dynamic growing economy. The adequacy of our statistical information influences in many ways our efforts to achieve improved economic stability, efficient use of our productive resources, and a satisfactory rate of economic growth.

Need for basic data

For example, there is a need to improve some of the basic data lying behind the national economic accounts. The technicians of OBE have repeatedly called attention to deficiencies in the data underlying their computations. They have pointed out, for example, that estimates of personal consumption expenditures are weakened because census wholesale and retail trade statistics do not have essential commodity information and are lacking in other detail.

They have shown that estimates of business investment and of changes in business inventories also suffer from the lack of adequate wholesale and retail trade statistics. They have argued that estimates of Government purchases of goods and services stand in need of better basic data regarding Government procurement. Yet needed improvements in these areas are still to be made.

Better basic data would meet other needs, too, and proposals for improvement should consider all uses to which data are put. The same kind of information which would strengthen the underpinnings of the national economic accounts would be directly relevant to other needs for information. These other needs of business, farm, labor, and research organizations for these data are only similar to, not identical with, the needs of the national economic accountants. Improvements geared strictly to the needs of the national economic accounts may not be adequate in themselves for business decisionmaking. Nothing is more likely to weaken users' enthusiasm for statistical improvements than the feeling that data furnished at considerable expense will produce information of limited usefulness for their purposes.

The current move to consolidate responsibility for retail trade statistics in the Bureau of the Census is a case in point. The proposed census program would lead to better data for national accounting purposes. At the same time the disappearance of the Federal Reserve Board department store statistics would mean a loss of geographic and commodity detail which many business and other users consider important. These users, therefore, have mixed feelings toward the proposed changes. Discussions are now going on to see how the new program can best produce detailed information needed for business purposes while better serving the needs of the national economic accounts.

Geographic detail in Federal statistics

The current discussions between representatives of the retail trade, the Bureau of the Budget, and the Federal Reserve Board emphasize the importance of adequate geographic detail if business is to make maximum use of Federal statistics. How far the Federal Government should go in meeting the needs for geographic detail is a continuing problem, and the answer will vary in different cases. It is clear, however, that modern methods of sampling used in data collection militate against the development of geographic detail. It is also clear that many important public and private policy decisions require better current information on a subnational basis than is now available.

In some cases, broad regional information is needed. In others, information by metropolitan areas would seem to be appropriate. In others, still different geographic breakdowns might be required. These

geographic breakdowns are not strictly necessary for the national economic accounts. Yet they are vital to any understanding of how changes in the level of different kinds of economic activity affect different parts of the country.

Anticipatory data

The national economic accounts framework has facilitated both long- and short-term projections of the likely performance of the economy. The annual forecast of the next year's gross national product has become a favorite indoor sport. While the forecast in the Economic Report is less detailed than many others which have appeared, the short section entitled "Outlook" is surely one of those parts of the Economic Report which attracts the greatest attention.

Today more than ever before, public and private decisions are a response, not only to existing conditions, but also to expected future conditions. This fact has led to a growing interest in statistical information which will yield some light on what future conditions are likely to be. This is seen in the ever present demand for more up-to-date information, for the more timely release of statistical data. It is seen also in the expressions of need for information directly related to the anticipated actions of consumers, businessmen, farmers, and Government.

In Federal statistics, there is already a series on anticipated business expenditures for investment. There is also an experimental series on consumer spending intentions. And there is, in the President's 1961 budget, a proposal that State and local governments supply information on their planned expenditures, a year in advance.

Is the Federal Government lagging behind in supplying this kind of information about its own activities? Many users think that it is and feel that a forward projection of Federal expenditures by quarters is a vital ingredient to a better evaluation of the short-term economic outlook. Certainly this kind of projection is a necessity for a proper understanding of the problems of budgetary and debt management. It would also promote a better understanding of the impact of defense expenditures on the economy.

New challenges

Our dynamic economy continually presents new challenges to those who prepare Federal statistical information. For example, in the allocation of human resources the emphasis in the economy has been moving from goods-producing industries to service-producing industries: trade, finance, personal services. Have our statistics kept pace with this change? It is obvious that they have not. Information about the trade and service industries is much more limited than that relating to agriculture and manufacturing. Federal statistics programs in the future will have to give more attention to these areas.

To take another example, the need for information to be derived from social statistics is receiving increased attention. We are beginning to recognize that questions relating to education, health, and welfare have an important bearing on the long-range performance of the economy. It is not clear whether existing data meet today's needs for information. It seems likely that, as these areas receive more attention, gaps and deficiencies in information will become more generally apparent.

In another area—agriculture—rapid technological changes and the continuing review of public policy have raised questions about the adequacy of present data. More and more, the discussion of farm problems tends to be in terms of commercial agriculture and noncommercial agriculture. Much of the information on agriculture now available would be infinitely more valuable if it were possible to relate it to commercial or noncommercial farms. Developments like this which would enable users of Federal statistics to better recognize that the farm problem is a number of problems would contribute significantly to raising the level of understanding of this sector of the economy.

Increasing demands for improved information and for new kinds of data to meet changing needs call for a continuing reexamination of existing statistical programs and a careful evaluation of proposed new programs to make sure that they meet as fully as possible the common needs of all users of Federal statistics.

During the past 3 years, the Federal Statistics Users' Conference has endeavored to contribute to this process of reexamination and evaluation. It has made a serious and continuing effort to identify and express the common user interest in better Federal statistics. The conference has supported budget proposals for statistical improvements in the past and welcomes the modest improvements contained in the 1961 budget.

The conference has been especially appreciative of the efforts made by this committee to develop better information on the economy. We hope that your efforts in this direction will continue.

I want to thank you for the invitation you have accorded us to appear here. If in any way, the conference can be helpful to you, please let us know.

Representative CURTIS (presiding). The Chair wishes to thank you very much for your appearance and this fine statement. Let me state my own personal hope that this will be an annual appearance on the part of your organization. I think it is an appropriate time when we hold hearings on the President's Economic Report because in that report are a good deal of economic data. I have always felt that one thing that we as a committee should do in our report on the President's report—our report to the Congress—is to comment on the caliber of the report from the standpoint of the use of data. I have personally urged that in the President's Economic Report there be some reference to this problem of economic statistics. I think your organization could be particularly helpful, as it is being helpful here today, if they would look forward to testifying each year before this committee. Possibly this testimony you have given is the result of a committee of your organization.

I think if they knew they could express themselves once a year, at any rate, and give advice to us, which of course is advice to the Executive, too, it would go a long way in directing the attention to this area.

One thing that I think would be helpful, too, would be giving us examples of how your various members use these statistics. That would help in many ways. It would certainly help those of us who will continue to appear before the Appropriations Committee in urging that we expand the program for economic statistics as we have this year.

I might say Congressman Bolling, who is chairman of our Subcommittee on Economic Statistics, and myself as the ranking Republican, appeared this year to urge that more moneys be put in certain areas which I think your group as much as any called to our attention.

Having said that I would at this time like to ask our acting staff director, John Lehman, if he has any specific questions he might like to ask.

Mr. LEHMAN. I think I have one or two, Mr. Curtis, that might be helpful.

I believe as you have gone through your statement you have in effect supported the recommendations in the President's Economic Report on page 69. Am I correct in that assumption?

The report lists the better crop and livestock statistics, the improvements in service trade statistics, the provisions for carrying forward the work initiated within the framework of the national income accounts, and so forth.

Mr. CHAROUS. Yes, I believe we would in general support any proposal for the improvement of the current statistical programs, and there are some listed here which we are definitely interested in.

Mr. LEHMAN. The other areas in which I was particularly interested, because I believe it is an area which is not spelled out in the President's report but which has quite a bit of appeal to persons working on projections of all kinds, is the proposed series for a forward projection anticipated of Federal expenditures by quarters. Would you consider this an important enough series to include in Economic Indicators if it can be established on a sound statistical basis?

Mr. CHAROUS. A quarterly series on Federal expenditures. You mean anticipated Federal expenditures?

Mr. LEHMAN. Yes.

Mr. CHAROUS. Yes, there is considerable support for such information in the Federal Statistics Users Conference.

Mr. LEHMAN. We know there is interest in the Government because of its relationship to problems of Federal economic policy. My question really was whether there was the equivalent interest outside and apparently you are saying there is.

Mr. CHAROUS. Yes. We have a committee that has been set up, as a matter of fact, which has communicated with Senator Douglas on this particular question. This committee has been set up for a particular purpose of trying to communicate the needs of statistics users for information on Government procurement. I think this series on anticipated Federal expenditures would be very helpful in that area.

Mr. LEHMAN. This is a letter which will be filed, Mr. Chairman, in the record of the procurement subcommittee hearings because it bears on their problems, too.

Mr. CHAROUS. The chairman of that committee is Howard Stier.

Mr. LEHMAN. I take it that the series you are proposing would be something more than just total anticipated Federal expenditures by quarters. You also would like some kind of rough breakout of defense expenditures?

Mr. CHAROUS. I don't feel I am particularly qualified to talk on the details of this proposal because we have a committee set up for that purpose and I am not a member of that committee. I am not too

familiar with their deliberations to date. They have not yet formulated a set of recommendations, to the best of my knowledge.

Mr. LEHMAN. You will have opportunity in the record, of course, to add any information which you and Mr. Lowry might like to get from that committee on that particular subject.

Representative CURTIS. Mr. Lowry, would you please identify yourself and make any comment you would care to make by way of addition to this discussion?

Mr. LOWRY. My name is Roye L. Lowry. I am the executive secretary of the Federal Statistics Users Conference. I have participated in the work of the Committee on Government Procurement Statistics. While no recommendations have been formulated, it is quite clear that the feeling of members of the committee is that they would like to have at least a breakdown of some rough character which would separate out national defense from other expenditures. But just in what detail or what form the breakdown would be in the final recommendation I don't think I could say.

Representative CURTIS. Thank you very much, gentlemen. I appreciate your appearance.

The committee will stand adjourned until tomorrow at 10 o'clock, at which time we will have a panel discussion on policy recommendations with Mr. Gordon, University of California; Paul Samuelson, MIT; William F. Butler, Chase Manhattan Bank; and B. U. Ratchford, Duke University.

The committee stands adjourned.

(Whereupon, at 3:55 p.m. the committee was recessed, to reconvene at 10 a.m., Friday, February 5, 1960.)

JANUARY 1960 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, FEBRUARY 5, 1960

U.S. CONGRESS,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in the Old Supreme Court Chamber, the Capitol, Hon. Paul H. Douglas (chairman of the committee) presiding.

Present: Senators Douglas (chairman of the committee) and Sparkman. Representatives Patman, Bolling, Curtis, and Kilburn.

Representative PATMAN (presiding). The committee will please come to order.

We have a panel discussion this morning. Senator Douglas is temporarily delayed, gentlemen, but he will be here soon.

We have on policy recommendations Mr. Robert A. Gordon, of the University of California; Mr. Paul Samuelson, Massachusetts Institute of Technology; Mr. William F. Butler, of the Chase Manhattan Bank, and Mr. B. U. Ratchford, of Duke University.

We are glad to have you gentlemen.

I wonder if you have prepared papers. If it is agreeable with you gentlemen, we would like to have each one of you use a few minutes on your papers.

After that, we will open the discussion up between yourselves and the members and among yourselves.

We will take you in the order in which you appear here.

Mr. Gordon, will you proceed.

STATEMENT OF ROBERT A. GORDON, UNIVERSITY OF CALIFORNIA

Mr. GORDON. Mr. Patman, members of the committee, while the President's Economic Report has, over the years, come to deal with virtually all economic aspects of the state of the Union, we must continue to judge it in terms of what it has to say about one question in particular:

Given the economic outlook, what policies will most effectively help us achieve a satisfactory combination of the three objectives of a high level of employment, reasonable price stability, and a satisfactorily rapid rate of growth.

As in the past, this year's Economic Report expresses confidence in the future, but carefully avoids both economic projections and a precise statement of policy—for example, in terms of a desired rate of growth, or a desired level of employment or output. It places its reliance almost entirely on a combination of monetary fiscal policy and exhortations to business, labor, and consumers to exercise re-

straint. And it lists virtually every legislative proposal having economic implications that the administration has made, whether or not these proposals arose out of a concern with problems of economic stability and growth.

The report places its chief emphasis on two recommendations:

1. Achievement of a $4.2 billion surplus to be used for debt retirement; and

2. Removal of the present ceiling on the interest rate which can be paid on new securities with a maturity of more than 5 years.

It seems to me that this latter proposal is thoroughly justified and that removal of the interest rate ceiling is overdue.

I also favor a planning of receipts and expenditures such that, at the levels of economic activity the administration anticipates, a budgetary surplus will ensue. Hence, I support the President's request that the corporate income tax be continued at its present rate, that the scheduled reduction in certain excise taxes be postponed, and that postal rates be increased. Clearly this is not the time for any sort of general reduction in taxes, particularly since expenditures may well turn out to be larger than proposed in the budget message.

Assuming continued business expansion this year, a budgetary surplus will help to ease the problem of the monetary authorities. Greater reliance on fiscal policy is, on the whole, to be welcomed, although it still remains to be seen what the Federal Reserve authorities will do if expansion in output is accompanied by a rise in prices which is deemed to be excessive.

I am sorry the report does not say more about the monetary aspects of a budgetary surplus. A surplus will have its maximum restraining effect if it is used to build up Treasury balances, particularly at the Federal Reserve banks. I do not think that the prospective situation calls for this kind of deflationary pressure. If the surplus is used for debt retirement, as intended, this means that cash formerly in the hands of corporate and individual taxpayers will be transferred to bank and nonbank holders of debt that is being retired. It can be assumed that the latter will seek to reinvest these funds, and this will help to restrain the rise in interest rates and will provide some moderate stimulus to private borrowing and to borrowing by State and local governments. The surplus will also tend to retard the expansion in the money supply, and, to that extent, may help the Federal Reserve authorities refrain from prematurely restrictive action.

It is clear that the administration still places primary reliance on nonselective monetary—fiscal policy—with the monetary policy being determined largely independently by the Federal Reserve authorities—on a miscellany of spending programs that directly or indirectly facilitate growth and, beyond this, on exhortations to labor and business to restrain their wage demands and price increases and to consumers to spend wisely.

I do not think that this is enough.

As I suggested to this committee last October in its hearings on employment, growth, and price levels—part 9–A—a reasonable set of goals for us to strive for is a rate of growth not far from 4 percent a year, an average level of unemployment—taking good and bad years together—not exceeding 4 percent and a rise in price not exceeding 1 percent per year.

We are not achieving these goals, and I think that the program laid out in the economic report is not enough to achieve them.

It is worth remembering that average annual unemployment has not been as low as 4 percent since 1953, the average rate of increase in constant dollar gross national product from 1955 to 1959 was only a little over 2 percent, 2.4 percent since 1953, and the Consumer Price Index has risen at slightly more than 2 percent per year since 1955—this was also the average rate of increase for the decade of the fifties as a whole.

It is becoming increasingly clear that primary reliance on nonselective monetary-fiscal policy will not achieve the goals we want. We must attack the problem of structural unemployment more directly and more imaginatively and, if we want more price stability than we have had in recent years, we must find new ways of coping with the wage-price problem. Given existing institutions that create an inflationary bias in the economy, I do not believe that the conventional instruments of monetary-fiscal policy can give us price stability without unduly slowing the rate of growth and creating a level of unemployment that most of us would find unacceptable.

I suggested in my earlier testimony some of the things which are needed to reconcile rapid growth and high-level employment with price stability. These suggestions fell, for the most part, into three groups:

Ways of coping with autonomous wage and price determining influences;

The need for selective monetary and fiscal measures; and

Methods of improving competition and the mobility of resources in the economy.

I shall not repeat the detailed suggestions here. But since these hearings are on this year's Economic Report, perhaps I can repeat one paragraph of what I said before this committee on an earlier occasion—hearings on employment, growth, and price levels, part 9–A, pages 2961–2962.

The President's Economic Report should be made into a more effective instrument for bringing public pressure to bear on private wage and price decisions. The Economic Report, virtually from the beginning, has tended to run in terms of broad generalities, well meaning exhortations that ask to be ignored, and innocuous platitudes * * *. I should like to see the Economic Report be more explicit about the objectives to be sought during the coming year and the combination of public and private policies needed to attain these objectives. In this connection, the administration should not be afraid to state frankly what range of wage increases it believes to be comparable with price stability, what needs to be done to accelerate increases in productivity, what policy measures it is prepared to take under various contingencies, and so on.

There are obvious risks in such frankness on which I do not have to elaborate. But we cannot get away from the fact that, given the economic power now residing in private groups and our desire to maintain existing free institutions, we must find ways of bringing public opinion to bear on the parties at interest in order to supplement the conventional instruments of economic policy. I agree with John Dunlop that "the full potential of the leadership of the Federal Government has never been used persistently and imaginatively to shape decisions by private parties on wages and prices or to influence the climate of ideas within which such decisions are made."

Thank you.

Representative PATMAN. Thank you, sir.

Mr. Samuelson, you are recognized.

STATEMENT OF PAUL SAMUELSON, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. SAMUELSON. Mr. Patman and members of the committee, in deciding what recommendations I, as an economist, ought to make, I must first judge what the betting odds are for the trend of business activity in 1960.

On the information now available, I believe the prudent man must agree that the administration's estimate of a 1960 gross national product averaging about $510 billion is an acceptable one.

This also means that the tax receipts estimated in the budget are reasonable, on the assumption, of course, that Congress follows all the President's recommended tax programs.

However, few Washington observers are rash enough to predict that will happen, and perhaps fewer still expect Congress to enact the postal rate increases and other expenditure programs in quite the form called for in the budget.

Moreover, the predicted cost of our agricultural program under present legislation seems to me to be understated in the budget estimates.

For the above reasons I find it more relevant to drop the official figure of $4.2 billion surplus in the administration budget.

For policy discussion we might more realistically think in terms of a budget surplus of $2 to $3 billion. And what does this imply for the economically more important concept of the cash budgetary surplus?

After we cut through all the bookkeeping details and shams, we find a likely surplus of what the Government actually takes from the community in receipts over what it pays out to the community, of something over $4 billion as against the corresponding official cash budget of almost $6 billion.

Evidently there are some important public misunderstandings about the economic meaning of the expected budget surplus.

First, many Wall Street traders have been saying that such a surplus is deflationary and has been attributing much of the sharp, but orderly, January decline in common stock prices to the prospect of a budget surplus.

Second, there is the widely expressed belief that a budget surplus is of itself a powerful force making for easier money. Both views are, to say the least, misleading.

(As a digession, two other current fallacies are worth mentioning. Often we hear that selling Government securities to the banks is inflationary. This is certainly wrongly stated: selling them to the Federal Reserve banks and thereby expanding member bank reserves would be inflationary, but, with the same Reserve Bank credit, lodging bonds firmly in the banking system would help to cut down on their expanding loans and would, if anything, clamp down on inflation.

(Purchases of bonds by the nonbanks have not been because people and businesses have been cutting down on their normal consumption and investment spending; so such a shift in debt holding from the banking system to the public has served to step up the velocity of circulation of money.

(Another fallacy is involved in the belief by the same man that:

(1. When the Treasury sells short term debt, that is peculiarly inflationary; but

(2. When the Federal Reserve, under the "bills only" doctrine that I shall discuss later, sells short term rather than long term bonds to the banking system via its ordinary open market operations, that is the optimal way to fight inflation.)

Mr. SAMUELSON. Returning from my digression, let me mention that the budget surplus will not be the result of new tax increases or expenditure reductions. The surplus will come solely from the built-in flexibility of our fiscal system: if the surplus comes at all it will come as the result of expansionary strength in overall demand, and this means that the creation of a surplus will serve to moderate the strength of the expansion rather than reverse the tide and create contraction.

I ought to mention in this connection that the envisaged surplus is not of an unusual magnitude. It will be less than 1 percent of gross national product which is a lower ratio than prevailed in the expansion following the 1954–55 recession.

Mr. SAMUELSON. By the same token, the expansionary conditions which are a prerequisite to the surplus will tend to put upward pressures on our already tight money market.

When the economy pays taxes in excess of its receipts, businessmen and consumers must scramble for enough liquidity to meet their tax obligations; so even if the Government were to retire public debt without any delay, there would be no net improvement in the overall liquidity of the economy and, hence, no reason to expect lower interest rates and greater availability of credit.

What is true is this: in the long run, as surpluses are used over a period of time to reduce the amount of outstanding Federal bonds that have to be held, the yields on governments should fall relatively to yields on corporate and municipal bonds, and to the degree that our economy attains the same nearness to full employment by levying higher rather than lower tax rates, the Federal Reserve can afford to create that much easier credit and lower interest rates, with the result that the community consumes less and invests more for growth.

What general policy implications follow from the above remarks?

First, the fact that we have a surplus is not an invitation to cut taxes.

Modern economists of diverse schools and philosophies preach in season and out of season that if you are bound to cut tax rates, the time best to cut them is in recession, not in boom.

Otherwise you are vitiating the important built-in stabilizing effect of fiscal policy.

Thus, if I were a Member of Congress who believed that first-class postal rates should be raised so as to make this service help cover other costs, I'd think 1960 a good year to raise those rates. And I certainly approve at any time the administration's recommendation that the capital gains loophole be denied assets which have been granted past depreciation tax allowances.

Second, and for exactly the above reasons, the economy can less afford a borderline governmental expenditure when overall demand is high than when low. This creates the paradoxical but economically

valid statement that, other things being equal, we can afford more expenditures when we are already running a deficit than when we are running a substantial surplus.

I wish the President and his Secretaries of Treasury would learn both halves of this whole truth, and perhaps somewhere in Congress this message might also have healthy information.

In a complicated subject like economics, you've learned from bitter experience not to expect ever to get simple, unhedged advice. So I must hasten to make two qualifications:

1. If there are vital public expenditure programs that you think the well-being of the economy makes mandatory—such as an enhanced space, missile, and aid spending—you must not let the fact that resources are in generally brisk demand stop you.

Increase such programs, knowing it is sound economic doctrine that our Nation can afford the public activities it needs.

This, however, is not an invitation to extravagance, for the same sound economic doctrines would call for increasing taxes by as much as or more than such expenditures if they threaten to bring you to overfull employment and zooming general prices.

America is very far from reaching an economic limit of taxation and getting farther below it with each passing year of productivity advance.

There has been a great deal of nonsense spoken on that subject and I have followed the whole discussion very carefully over a period of years. I would like to give my opinion that America is actually getting further below any such possible limit on taxation with each passing year of productivity advance. That was by first qualification.

My second is this:

My remarks about encouraging a surplus under present conditions are, among other things, premised upon the correctness of the view expressed in the Economic Report of the President, not necessarily my view:

> As we look ahead, there are good grounds for confidence that this economic advance can be extended through 1960 * * * (and) can carry well beyond the present year. [P. iii.]

Some economists, perhaps a minority, expect there to be a business downturn within the second half of 1960 itself. More economists expect that there will be a slowing down of the rate of expansion in the last half of 1960 with a downturn to follow sometime in 1961.

I don't want to canvass the opinions of all the experts, but it may be the majority view of the experts that the report's words, "well beyond the present year," are a mite overoptimistic, or, at least, euphemistic.

Inasmuch as you are now planning for a period which will not be over until July 1, 1961, some 17 months from now, the possibility of a recession beginning in 1961 must be given some weight in your thinking.

In view of the notorious difficulty in forecasting very far ahead, I would not urge too much consideration to this issue were it not for another fact carefully avoided in this year's economic report.

The Council of Economic Advisers cannot be accused of having made a pessimistic forecast for 1960. Yet surely they know that a gross national product of $510 billion must necessarily imply an unemployment rate of appreciably more than 4 percent of the labor force.

Why was this fact deliberately soft pedaled in the Economic Report?

I can only guess, but it seems a reasonable hypothesis that they also know the American people do not share their complacency about the 5½-percent unemployment rate that has prevailed on the average during the expansion and contraction periods that have occurred while the present Council has been in office.

Certainly few legislators, on the floor of Congress or back home, would stand by the first part of the report's assertion:

> In general, unemployment rates in the United States have not been high for an economy which allows and experiences considerable labor mobility and job change, but they can and should be lower.

Scholars who have studied job mobility here and abroad, in this decade, and in earlier times, know very well that unemployment rates of 4, 5, and 6 percent, are not attributable to ordinary job turnover.

What is the bearing of this on policy? If unemployment were the only consideration, the desirability of preserving a sizable budget surplus in fiscal 1961 would be very much less than I indicated in my remarks.

It is to the degree that you deliberately hope to rely on a sizable level of excess unemployment in the economy to counteract inflationary pressures and our "unfavorable balance" of international payments that you will be eager to push toward surpluses as high as or higher than those recommended by the President for a 1960 gross national product of $510 billion.

In conclusion, I ought to say a few words about monetary policy, especially since the present administration considers this outside its own province, being, instead, the responsibility of the Federal Reserve and the Congress to which the Federal Reserve is in turn responsible.

Time requires me to be brief, but I shall be glad to enlarge on my views in our later discussion.

1. Our gold position is not now acute. And for precisely that reason this is the time, while we are in strength, to take those desirable actions which it would be more embarrassing to take in the midst of an emergency.

I strongly recommend that Congress speedily remove the 25-percent gold requirement which the Federal Reserve banks are now required to hold against their notes and deposits.

There seems to be some question whether an act of Congress is needed, but for the purpose I have in mind an act of Congress is very much needed, whatever the technicalities.

Such reserve requirements have no technical economic foundation. They are archaic and do not serve a useful purpose in controlling inflation.

Any psychological effects abroad of such a move would, at this time, be temporary and will in the longer run be favorable.

Reputable financial experts like Roy Reierson, vice president of the Bankers Trust Co., and Sir Oliver Franks, president of Lloyd's Bank of London, have already recommended legislation to remove this gold requirement. I heartily concur.

2. Last year, before this had become a national issue, I told this committee that the time might soon come when you would want to repeal the archaic 4¼ percent interest ceiling on Government bonds of over 5 years' maturity.

Except as a symbol of dissatisfaction with a policy of tight money to fight inflation, such a ceiling accomplishes no useful purpose and does limit the efficiency of the Reserve authorities and Treasury.

Similarly, the public debt ceiling is not a desirable economic policy.

Having said this, and established my credentials, so to speak, I ought to point out that the interest ceiling is not the vital issue that Wall Street journalists purport to believe.

3. Since 1953 the Federal Reserve Board has by its own volition been confining its ordinary open market operations to short-term Government securities. This "bills only" doctrine was hotly contested at the time by the New York Federal Reserve Bank, and, I may say, by others, and were it not for fear of the Washington authorities, there would have been even greater opposition from other regional Reserve districts.

I recall that out of 20 supposed expert economists gathered in Washington in another connection for an informal policy meeting, only 3 were in favor of bills only, with another few willing to reserve judgment until experience had accumulated.

The remaining majority of two-thirds thought the doctrine would, if anything, weaken orthodox central banking and thus undermine both stabilization and the degree of freedom from more direct controls that our enterprise economy can enjoy.

Events of the last 6 years do not seem to have borne out the claims of the bills only—or bills usually—doctrine. Bond markets have not been noticeably more orderly.

To get the same expansionary effect in the 1953–54 recession, the Fed had to create that much more bank reserves than would have been necessary with orthodox open-market purchase of long-term Governments.

To be sure, by open-market operations in bills alone, one can also affect long-term rates and long-term investment spending.

But the process becomes unnecessarily indirect, and the burden of debt management is not thereby avoided but, instead, is needlessly thrown completely on the shoulders of the Treasury rather than being handled in a coordinated manner.

Coordination does not mean keeping money cheap for the Treasury but, rather, has the goal of optimal monetary policy for reasonably high growth, employment, and price stability.

Although it is not Chairman Martin's intention, adherence to bills only might, ironically, increase the likelihood under present institutions that the debt would come to consist primarily only of short-term securities. Bills only leading to only bills is an eventuality no one really wants.

In the present situation, without bills only, the Federal Reserve could right now be operating in the open market by selling long-term bonds if inflationary dangers called for pushing more long-term debt on the public banking system.

This is appropo of the 4¼-percent ceiling discussion.

And when interest rates later ease, the Federal Reserve could buy back such bonds or help the Government lengthen out its debt structure—thereby achieving the claimed interest economies and other advantages of an extended debt, and enabling all this to happen without jeopardizing the stimulus to long-term investment at that time so desirable.

Some of the opposition statements on this point seem to me to be perhaps a little muddled.

Mr. SAMUELSON. More than ever the bills only doctrine is an albatross around our necks.

As Professor Kereken, of Minnesota, has rightly pointed out, the state of our balance of international payments may in the years ahead put constraints on our pursuing a short-term interest rate policy most conductive to stabilization, All economists fear this.

Why, then, should the Federal Reserve be stuck with a policy of its own making that prevents it from creating to the national advantage differential movements in yields on long- and short-term Government securities? Long-term rates in some measure could be emancipated from the bill rate needed to hold foreign funds.

For these reasons, I would urge members of both political parties in Congress, to which the Federal Reserve System is and ought to be responsible, to make known by resolution, moral suasion, or legislation the prudent desirability of removing the hobbles to central bank policy represented by the bills only doctrine.

Finally, let me mention in connection with monetary policy that the interest cost of the debt has been rising in recent years.

I am not one of those unduly alarmed by this fact, or apprehensive that the resulting increase in disposable income will result in a net inflationary impact.

But there are people who so worry.

May I suggest there is an alternative to meeting this problem other than that of engineering cheaper money. Instead, the Federal Reserve could—

1. Raise legal reserve requirements of the member commercial banks while;

2. At the same time carrying out any needed offsetting open market purchases of Government securities.

This could give us—

A. A reduction in net interest outlay by the Government—since enhanced Federal Reserve earnings are returned to the Government; and

B. At the same time we can continue to have as restrictive a credit policy as the economic situation really calls for.

Representative PATMAN. Thank you very much, Mr. Samuelson.

Mr. Butler, of the Chase National Bank, you are recognized, sir.

STATEMENT OF WILLIAM F. BUTLER, OF THE CHASE NATIONAL BANK

Mr. BUTLER. As I understand our assignment, it is to comment on the policy recommendations in the President's Economic Report.

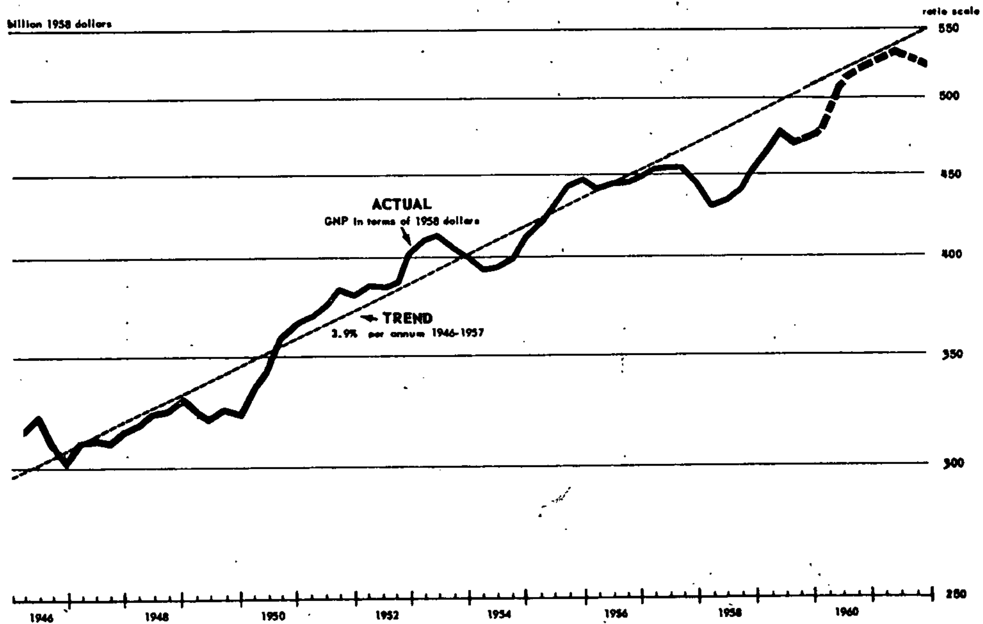
I can deal with this with great dispatch.

I find the policies set forth in the report generally sound. I agree with its conclusion that this will be a year of high production and employment.

If you will turn to the chart which is attached to this statement, you can see where the economy is and where I think it is going.

(The chart referred to follows:)

POSTWAR GROWTH TREND



THE CHASE MANHATTAN BANK

Mr. BUTLER. The chart shows gross national product—in constant 1958 dollars—from 1946 to date, and our forecast through 1961.

The trend line is mathematically fitted to the data for 1946–48. I believe a fitted trend line is the best way to measure growth.

The significant fact is that the economy returned to this trend after the two previous recessions. Our forecast is that we shall regain it once more this year and move ahead into 1961.

On the postwar business cycle pattern, one would look for another recession starting some time in 1961. There is no way at present to predict just when it might come. But the odds favoring a downturn will modify rapidly as we move through 1961.

What does this view of the business outlook mean for national economic policy? First, it points to the need for policies of monetary and fiscal restraint in the near future.

In my view, the Nation can and must check inflation. This means tight money, a budget surplus, and efforts to hold the increases in wages in line with the overall advance in the economy's efficiency. I believe such policies can give us a stable price level and rapid economic growth—which means that I find the analysis of the staff of this committee unconvincing on this score.

An attitude of restraint should also help moderate the next recession. The seeds of recession are sown in the boom that precedes it.

This leads to my second point; we should start now to deal with the next recession.

In addition to restraining the boom, we should take other steps. Our unemployment insurance system needs to be improved.

Our economic intelligence network needs reinforcing.

And we need to prepare ourselves to use fiscal policy with greater imagination.

I personally would favor cutting taxes in time of recession if I had the assurance that tax rates would be increased when inflation threatens.

While we are coping with inflation in the period immediately ahead and preparing to deal with the next recession, we should also be working to accelerate our long-term rate of economic advance. I say this, even though I do not believe a review of the evidence shows that our growth has slowed in recent years.

Measuring our growth has become a new numbers game—if you want to play it one way, the average annual growth rate from early 1945 to 1953 was 2.6 percent, as against 2.9 percent from 1953 to 1960, on our projection.

The chart before you gives what I believe to be the true picture, a tendency toward 4-percent growth characterizes the postwar period.

We have a set of institutions that generate a long-term growth rate of 4 percent, marked by the ups an downs of the business cycle.

It is my belief that we could accelerate our economic growth, without inflation, if we could develop a national consensus that would support certain moderate changes in some of our economic arrangements. We need to revise our tax system to reduce the burden it places on saving and investment, initiative and enterprise.

We need to remove some of the barriers to growth in the form of a costly and ineffective farm program, archaic restrictions on efficiency on the job, undue restrictions on international competition, and regu-

latory policies that make our transportation system less efficient than it could be.

At the same time, we should improve the quality of our educational system and deal imaginatively and realistically with the tremendous problems of metropolitan areas.

I have no illusions that it will be easy to accelerate our rate of economic growth. To the contrary, it will require hard and intelligent work and hard choices. We will not achieve growth by a complacent acceptance of easy policy, or by the seemingly easy route of massive Government spending.

The imparatives of growth are saving and investment, research and development, imaginative business planning and management, and wise national economic policies.

If we as a nation want to grow faster, we can—if we are willing to work at it, and support policies that will encourage genuine growth.

Thank you.

Representative PATMAN. Thank you, sir.

Mr. Ratchford, of Duke University, you are recognized, sir.

STATEMENT OF B. U. RATCHFORD, DUKE UNIVERSITY

Mr. RATCHFORD. Mr. Chairman, members of the committee, I have a statement which is too long to read.

If I may offer it for the record, I will very briefly summarize the first seven pages and then read the last four.

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

Mr. RATCHFORD. Thank you.

Representative PATMAN. You may summarize it in any way you choose.

(The statement referred to follows:)

STATEMENT BY B. U. RATCHFORD, DUKE UNIVERSITY

Mr. Chairman and members of the committee, I thank you for this privilege of appearing before you to make policy recommendations for the coming year. I have no startling recommendations to make nor any large programs to propose. Rather, it is my hope that these recommendations might lead to an improvement of operating procedures and to a better perspective on the pattern of our expenditures.

My first recommendation is simple and deals with procedures rather than substance. The President has recommended that the ceiling on bond interest be repealed and that the limit on the amount of debt be raised. I would recommend that both of these be repealed—that both ceilings be abolished. This would be a desirable move for several reasons. First, I have seen no evidence that either of these ceilings has been beneficial in its effects. On the contrary, these restrictions, whenever they have been effective, have been harmful; they have curtailed the Treasury's freedom of action in managing the debt, have led to a still more unbalanced debt structure, and have probably increased the total interest cost of the debt.

Second, these features have been matters of much controversy and have taken up much time, attention, and effort, both in the Congress and in the Treasury, effort which might more profitably have been devoted to more important matters. Because of the undue public attention they have received, they have probably caused much public confusion and misunderstanding. It would not be surprising if the unsophisticated taxpayer, judging by the attention these ceilings have received, should think that they are major safeguards of the financial stability of our Government. Both limitations cater to the popular belief that difficult and complex problems can be solved by relatively simple and superficial gimmicks.

Finally, with these restrictions, we are setting a bad example for those countries which look to us for guidance and assistance in financial matters. Indeed, we would probably criticize any country receiving aid from us which managed its debt as our Treasury has been forced to manage ours under these two restrictions.

II

My second recommendation is more complex and not so easily explained. It deals primarily with our balance of payments problem, although it may have implications for the pattern and amount of our expenditures.

The problem of our balance of payments is well known and does not require elaboration here. Both the budget and the Economic Report discuss it at length. Both indicate that the Government is deeply concerned about it and is taking steps to deal with it. Neither of those documents, however, give sufficient information about, nor adequate analysis of, a major and persistent element of the problem which, in my opinion, is causing much of the present difficulties. I refer to the payments arising directly and indirectly out of the activities of the U.S. Government in the foreign field. My recommendation is that we assemble and study all the data on such payments before making decisions about expenditures in that field.

Permit me to say here that I am not greatly disturbed by the recent outflows of gold nor by the deficits in our balance of payments in the past 2 years if those can be regarded as isolated developments. But if they are to be, in some measure, permanent features of our international transactions, they can be serious indeed. For a number of reasons I believe that we are likely to have larger deficits in our balance of payments in the years ahead than we have had since World War II unless basic corrective actions are taken. Allow me to say, also, that this is not an attack on foreign aid. My recommendation is that we make our decisions about foreign aid in the light of all the relevant facts, including our balance of payments situation, rather than solely on the basis of a pattern which was established in the immediate postwar years.

Insofar as my limited knowledge goes, there has been no comprehensive effort to assemble and analyze all the expenditures of the United States which give rise to payments abroad. The Economic Report (p. 52) gives a partial list, but it leaves out some of the major items, and it does not give a total of those which it does list. Such a total would have to include the following: (1) Military assistance; (2) other military expenditures abroad, including expenditures by military personnel; (3) economic grants and loans; (4) transactions of the Export-Import Bank; (5) transactions of the Development Loan Fund; (6) transactions under Public Law 480; (7) subscriptions to the International Bank; (8) subscriptions to the International Monetary Fund; (9) subscriptions to the International Finance Corporation; (10) subscriptions to the International Development Association; and (11) subscriptions to the Inter-American Development Bank. There may well be other agencies I have overlooked. In addition, the list would have to include the regular expenditures of the State Department, of the Central Intelligence Agency, and perhaps of other departments and agencies.

Some of these items are not foreign aid, but they all affect our balance of payments and most of them are largely, if not entirely, designed to provide military or economic assistance. I do not know what the total would be, but it would be far greater than the amount which is usually discussed as the amount of our foreign aid. One series of data covering most of these items shows totals rising steadily from $4.7 billion in 1950 to $8.4 billion in 1958, an increase of nearly 80 percent. The $8.4 billion is equal to about one-half of our exports of merchandise and to somewhat more than a fourth of our total payments abroad in recent years.

Whatever the exact amount may be, it is a major element in our balance of payments. Perhaps equally important is its behavior; it tends to rise over the years, and it is not flexible in response to changes in relative interest rates and price levels. In other words, it does not facilitate an automatic adjustment in the balance of payments. In fact, to the extent that the total is made up of military expenditures, it might be perversely elastic in that the total would rise with rising price levels abroad.

In the immediate postwar years our program of foreign aid was designed and justified in view of the conditions prevailing at that time. Most of the major nations had industrial systems which had been devastated by war, their inven-

tories of goods were greatly depleted, their reserves of gold and dollars were almost nonexistent, and they faced huge deficits in their balances of payment. So the United States assumed the obligation of helping to reconstruct industrial facilities, to cover balances of payments, and to build up gold and dollar reserves. We shouldered the vast majority of the burden of assisting underdeveloped countries. When joint or cooperative projects were undertaken, such as the International Bank or the International Monetary Fund, it was customary for the United States to assume 30 or 40 percent or more of the total financial load. A great majority of this aid could be, and was, in the form of goods; capital goods to build up producing capacity and consumer goods to maintain a minimum standard of living and replenish inventories. For 10 years this aid helped to maintain a strong and sustained demand which gave us high incomes, high profits, and high wages.

Now nearly all of this has changed. Industrial facilities have been rebuilt at a level more efficient than before the war. Inventories have been replenished, considerable gold and dollar reserves have been accumulated, and now we are the ones facing a difficult balance of payments problem. Now the other countries do not have such a strong demand for our goods; in fact, many of them are competing strongly with us in the sale of both producer and consumer goods. Yet the pattern of our military and economic assistance has changed little. We still pay the entire cost of our troops abroad, including purely local expenditures, and help our NATO allies with their expenditures. When joint enterprises are proposed, the United States is still supposed to pay a third or more of total expenses. None of our free-world allies has assumed any significant part of the burden of assisting underdeveloped countries. Now a considerable part of our aid is being taken in the form of money to be used to buy goods from our international competitors. This is one of the important reasons why we are likely to have a problem with our balance of payments for a long time to come.

For all these reasons, we should reconsider our system of payments abroad in the light of the changed circumstances. We should then attempt to determine (*a*) whether there is need for us to continue our present pattern and amount of foreign aid and (*b*) whether our balance of payments will permit us to do so.

III

My third recommendation is similar to the second one in form, but it deals with the general subject of social security and welfare expenditures. I am using this topic to cover all social security programs and public assistance but not veterans' benefits and expenditures for education; it covers the transfer expenditures from the social security trust funds as well as expenditures from the administrative budget. My recommendation is that our policy in this field should be reappraised in the light of the developments of the past 10 years and of all relevant circumstances of the present.

Two characteristics of expenditures in this field make a careful examination desirable. First, neither rates of benefit nor total expenditures can ever be reduced; on the contrary, total expenditures will almost inevitably increase steadily. Second, expenditures of this kind lend themselves especially to political manipulation in an effort to win votes.

Expenditures in this field have had a phenomenal rise on any basis of measurement. In the cash budget, the item "Labor and welfare" rose from fifth position in 1948 to second position in the estimates for fiscal 1960. In the present year, the amount of $19.8 billion is more than twice as large as any other item except national defense. Three items make up a large majority of this total—OASI, railroad retirement, and public assistance. In 1960 the total of these three items, at $14.7 billion, is 6½ times as large as it was in 1950; the annual increase ranged from 15 percent to 39 percent, and averaged 21 percent. The Social Security Administration's tabulation of social welfare expenditures under public programs includes expenditures of State and local governments as well as Federal expenditures. Excluding veterans' programs and educational expenditures, that total in 1958 was $24.4 billion, or nearly four times as large as it was in 1948. The annual increase ranged from 4 percent to 26 percent, and averaged 16 percent. A striking characteristic of both of these series is that there is only a slight tendency for percentage increases to decline as absolute amounts increase.

Another way of putting it is that we are now spending for welfare in its various phases more money than all governments in this country spent for all purposes in any year before 1940.

In this field, then, we have had a very rapid rise to a high level of expenditures. Perhaps this is what we want and perhaps it may be justified, but it would seem to call for a careful look to see where we are heading and whether our speed is justified.

In one respect, especially, we have not been clear about our goal. When the social security system was established, it was planned to operate it on an actuarial or funded basis. That probably was not a realistic or attainable goal at the time. In any event, we have, without any clear statement of policy, gradually shifted over toward a pay-as-you-go basis. First, during and immediately after the war, as unexpectedly high levels of employment and wages built the reserve up to levels higher than had been anticipated, the Congress repeatedly postponed scheduled increases in the rates of the payroll tax. Within the past 10 years, however, successive liberalizations in the rates and coverage of benefits have required increases in the rates of the tax and in the amounts of wages covered by it. Even so, those increases, together with steadily rising levels of wages, have not been sufficient to meet the ever-increasing payments and for the 3 years ending on June 30, 1960, the total deficit of the OASI trust fund will be about $2½ billion. Further, despite a substantial increase in the rate of payroll taxes on January 1, 1960, the Budget (p. 843) shows that the OASI trust fund will have practically no increase in fiscal 1961. If payments continue increasing at anywhere near the rate of recent years, it will be necessary either to make further substantial increases in the payroll tax or to make very large transfers from the general fund.

The deficit of $2.5 billion in the OASI trust fund in the past 3 years has required the liquidation of an equal amount of Treasury obligations. This came at a most inopportune time for the Treasury and greatly contributed to its difficulties in managing the debt. Each year for the 10 years ending with 1956, the OASI fund had absorbed large amounts of Treasury obligations and in that way had facilitated the management of the debt. Then, at the same time when other important sources of demand for Treasury securities were drying up, it was forced to reverse its practices and to liquidate securities. This has forced the Treasury to search desperately for other sources of funds. In the process it has kept the financial markets upset and off balance.

Time permits only brief mention of some economic effects of the greatly increased welfare and transfer payments. First, they sustain personal incomes and personal consumption expenditures in periods of recession and augument them in periods of high prosperity. It has been a characteristic of every period of recession of the past 15 years that personal incomes and personal consumption expenditures have held up much better than GNP or national income. The latest example of this, on a very small scale, was the third quarter of 1959. Because of the steel strike, GNP and national income dropped perceptibly. Both personal income and disposable personal income held steady while personal consumption expenditures rose slightly. This was desirable in that it helped to stabilize the economy. But it must be remembered that, in periods of high incomes, this same force is at work to increase inflationary pressures.

If it is true, as some contend, that one of our great weaknesses is that we are encouraging private expenditures for consumption at the expense of public expenditures which would bolster the Federal Government's power and prestige in the world, then rapidly increasing expenditures for welfare accentuate that trend. The taxes to support these expenditures, whether earmarked or general, gather funds from all sectors of the economy, with varying propensities to consume. The expenditures funnel them into an area where the propensity to consume is very high. The net effect must be an increased demand for consumer goods and services. This effect is accentuated if we shift from a system of reserve financing to a system of pay as you go or to one of deficit financing as in the past 3 years with OASI.

Since the Social Security System was established, and especially in the past 10 years, several far-reaching changes have taken place in the economy which have a bearing on the need for social insurance and welfare payments. These should be taken into account when appraising the speed with which Federal outlays have increased and in determining the need for further legislation which would increase or extend benefits. Perhaps the most important of these has been the establishment and very rapid growth of private pension plans. At the end of 1957, these plans covered nearly 18 million workers and had accumulated reserves of some $35 billion. Undoubtedly, both of these figures have increased substantially since then. Second, most State and local

governments have established retirement or pensions systems. In 1957 there were over 2,200 such systems, covering more than 4 million workers, paying benefits to over 500,000 persons, and holding reserves of nearly $13 billion. Again, these figures have certainly risen since then. Third, there are now over 22 million veterans in our population, most of whom will be eligible for some benefits sooner or later. In 1958, over 3,700,000 of them were drawing over $5 billion in benefits.

There are, of course, many duplications in these different categories, and it may well be that one person is receiving two or even three separate benefit payments. This and other relevant aspects of the situation should be reviewed in considering changes in social insurance and welfare payments at the Federal level.

Mr. RATCHFORD. I make three major recommendations:

The first is that the ceiling on the interest rate and amount of debt be repealed. I believe that has been sufficiently elaborated here, so I will not discuss my recommendation.

My second recommendation has to do with our policies in the field of foreign trade and particularly with the amount of governmental expenditures and transfers abroad. This matter has been dealt with in the study paper by Dr. Bernstein, which I did not know of and had not seen when I wrote my paper. So I will omit that with the comment that Dr. Bernstein's paper covers it very adequately and with almost everything that he says I am in agreement.

My third recommendation deals with our policies with respect to social insurance and welfare.

I begin reading on page 8 of my statement:

Expenditures in this field have had a phenomenal rise on any basis of measurement. In the cash budget, the item "Labor and welfare" rose from fifth position in 1948 to second position in the estimates for fiscal 1960. In the present year, the amount of $19.8 billion is more than twice as large as any other item except national defense.

Three items make up a large majority of this total, OASI, railroad retirement, and public assistance. In 1960, the total of these three items, at $14.7 billion, is 6½ times as large as it was in 1950; the annual increase ranged from 15 to 39 percent and averaged 21 percent.

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In this field, then, we have had a very rapid rise to a high level of expenditures. Perhaps this is what we want and perhaps it may be justified, but it would seem to call for a careful look to see where we are heading and whether our speed is justified.

In one respect, especially, we have not been clear about our goal. When the social security system was established, it was planned to operate it on an actuarial or funded basis. That probably was not a

realistic or attainable goal at the time. In any event, we have, without any clear statement of policy, gradually shifted over toward a pay as you go basis. First, during and immediately after the war, as unexpectedly high levels of employment and wages built the reserve up to levels higher than had been anticipated, the Congress repeatedly postponed scheduled increases in the rates of the payroll tax. Within the past 10 years, however, successive liberalizations in the rates and coverage of benefits have required increases in the rates of the tax and in the amounts of wages covered by it.

Even so, those increases, together with steadily rising levels of wages, have not been sufficient to meet the ever-increasing payments and for the 3 years ending on June 30, 1960, the total deficit of the OASI trust fund will be about $2½ billion. Further, despite a substantial increase in the rate of payroll taxes on January 1, 1960, the budget (p. 843) shows that the OASI trust fund will have practically no increase in fiscal 1961. If payments continue increasing at anywhere near the rate of recent years, it will be necessary either to make further substantial increases in the payroll tax or to make very large transfers from the general fund.

The deficit of $2.5 billion in the OASI trust fund in the past 3 years has required the liquidation of an equal amount of Treasury obligations. This came at a most inopportune time for the Treasury and greatly contributed to its difficulties in managing the debt. Each year for the 10 years, ending with 1956, the OASI fund had absorbed large amounts of Treasury obligations and in that way had facilitated the management of the debt. Then, at the same time when other important sources of demand for Treasury securities were drying up, it was forced to reverse its practices and to liquidate securities. This has forced the Treasury to search desperately for other sources of funds. In the process it has kept the financial markets upset and off balance.

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First, they sustain personal incomes and personal consumption expenditures in periods of recession and augment them in periods of high prosperity. It has been characteristic of every period of recession of the past 15 years that personal incomes and personal consumption expenditures have held up much better than gross national product or national income. The latest example of this, on a very small scale, was the third quarter of 1959. Because of the steel strike, gross national product and national income dropped perceptibly. Both personal income and disposable personal income held steady while personal consumption expenditures rose slightly.

This was desirable in that it helped to stabilize the economy. But it must be remembered that in periods of high incomes, this same force is at work to increase inflationary pressures.

If it is true, as some contend, that one of our great weaknesses is that we are encouraging private expenditures for consumption at the expense of public expenditures, which would bolster the Federal Government's power and prestige in the world, then rapidly increasing expenditures for welfare accentuate that trend. The taxes to support these expenditures, whether earmarked or general, gather funds from all sectors of the economy, with varying propensities to consume. The expenditures funnel them into an area where the propensity to

consume is very high. The net effect must be an increased demand for consumer goods and services. This effect is accentuated if we shift from a system of reserve financing to a system of pay as you go, or to one of deficit financing, as in the past 3 years with OASI.

Since the social security system was established, and especially in the past 10 years, several far-reaching changes have taken place in the economy which have a bearing on the need for social insurance and welfare payments. These should be taken into acount when appraising the speed with which Federal outlays have increased and in determining the need for further legislation which would increase or extend benefits.

Perhaps the most important of these has been the establishment and very rapid growth of private pension plans. At the end of 1957, these plans covered nearly 18 million workers and had accumulated reserves of some $35 billion. Undoubtedly, both of these figures have increased substantially since that time.

Second, most State and local governments have established retirement or pension systems. In 1957, there were over 2,200 such systems, covering more than 4 million workers, paying benefits to over 500,000 persons, and holding reserves of nearly $13 billion. Again, these figures have certainly risen since then.

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There are, of course, many duplications in these different categories, and it may well be that one person is receiving two or even three separate benefit payments. This, and other relevant aspects of the situation should be reviewed in considering changes in social insurance and welfare payments at the Federal level.

The CHAIRMAN. I wish to apologize to the members of the panel and my colleagues for being late. Inasmuch as Mr. Patman was acting chairman in my absence, he should be the first to question.

Representative PATMAN. I assume we will be under the 10-minute ruling the first time around, 20-minute rule the second time, and unlimited the next time.

The CHAIRMAN. That is right.

Representative PATMAN. I would like to invite your attention to an article appearing in today's Washington Post by Gardiner C. Means, in which the Post editor adds:

> A prominent economist and authority on administered pricing, Dr. Means was coauthor of the now classic "Modern Corporation and Private Property."

Representative CURTIS. Mr. Chairman, a point of order.

I would like to have the entire article placed in the record.

Representative PATMAN. I am going to read it.

Representative CURTIS. Wait. You say you are going to read the whole article? I want the entire article in the record.

Representative PATMAN. This is:

INTEREST RATE ISSUES

> Your January 31 editorial on Government interest rates troubles me. It seems to imply that because long terms could now be sold at a lower current interest rate than short terms, their interest cost to the American public would be less. This would be a very shortsighted view.

In historical perspective, interest rates are now high and we can reasonably expect propesperous periods in the future when interest rates will be much lower. To issue long terms at 4½ percent or more can commit the public to high rates for 30 or 40 years. The temporary payment of a somewhat higher short-term rate will allow refunding to wait until long-term rates are lower.

At no time in the last 40 years has the Government paid more than 4 percent on its long-term issues. It has not even used the power to pay 4¼ percent.

I cannot imagine a competent financial counselor advising a big, solvent corporation to refund its short debt into long terms at the present time in the light of the high current rates, the long history of lower rates and the known policy of tight money.

It seems to me that the 4¼ percent limit is a sound and needed protection of the public interest. There is always the danger that an administration, whether Republican or Democratic, will through poor judgment or through too close association with the financial community, saddle the public with 30 or 40 years of unnecessarily high interest charges. It would seem to be a legitimate exercise of congressional responsibility and wisdom to guard against this danger by setting a limit so that refunding into long terms can only be done when long-term rates are below 4½ percent.

That the danger is real is suggested by the history of the last few years. The present administration came into office with the announced intention of (1) bringing about higher interest rates and (2) refunding the Government debt into longer terms. Both objectives made some sense at the time, particularly the latter because of the intention to bring about higher interest rates.

However, the administration worked on the first and not the second, so that today interest rates are high while the average duration of the public debt is shorter than 7 years ago. The sudden urge to be active in refunding the debt for a long period to come, at high rates, can hardly help but raise the question of Why? in the light of the inaction during the last 7 years.

GARDINER C. MEANS.

VIENNA, VA.

Most of you gentlemen have indicated this 4¼ percent rate should be repealed. I assume you do that on the theory, one theory being that the competition in the money market would ease interest rates.

Is it your understanding, Mr. Gordon, that you have more savings when interest rates are high?

Mr. GORDON. I am not sure that within the range that we have had in recent years an increase in interest rates leads significantly to an increase in personal savings. The changes in structure of interest rates may rechannel savings.

We had an example of that in the issue of the so-called "fabulous fives" recently, when personal savings moved out of savings accounts and savings and loan shares into purchases of this Federal security.

Representative PATMAN. May I poll the panel on this. How many of you believe that higher interest will induce savings?

Mr. RATCHFORD. I would say to a limited extent.

Mr. SAMUELSON. Do you want a "yes" or "no" answer?

Representative PATMAN. Yes, sir.

Mr. BUTLER. I will say yes; I think it will.

Representative BOLLING. What does Mr. Samuelson say?

Representative PATMAN. He did not vote on it.

Mr. SAMUELSON. I hate to use up Mr. Patman's time to enlarge on my views.

Representative PATMAN. You are very considerate, sir. I appreciate that. I will not pursue that for the present until I have more time.

You see, we have more time as we go around the table.

I do not want to impose on these other gentlemen, but I will bring that up later on.

Representative CURTIS. Are you interpreting Mr. Samuelson as voting in favor or against it?

Representative PATMAN. I can see from his attitude that he wants to express an opinion about it. In other words, to elaborate on his answer. I do not assume that to be a categorical reply.

If higher interest really induces savings, of course, we have some reason to have higher interest, but I think the record shows that it has not induced savings in the past.

I think that there is a difference between interest on actual savings and interest on manufactured money.

You see, when you increase interest on actual savings of people you increase interest on manufactured money, too. For instance, the Federal Reserve Bulletin for this month has a column, which I called to the attention of Chairman Martin the other day, that shows the number and amount of securities of States and political subdivisions held by the commercial banks and they are about 30 percent of the entire total.

So the point I am making is that commercial banks in buying those tax-exempt securities, do not pay money for them; they create money on the books of the banks to buy them.

They are not out money for them at all.

I think that creates a terrible inequity in our country when people vote bonds in these small communities and many of them do not own their property that they are paying taxes on, they owe for it. So they are paying taxes on what they owe to pay for those bonds and interest and paying them to concerns that manufactured the money to buy the bonds.

To that extent I think it is very unfair. What do you think about that, Mr. Samuelson?

Mr. SAMUELSON. Well, I have some remarks at the end of my paper which perhaps bear on this subject and at earlier meetings of this subcommittee, the subject was touched on.

Let us suppose that you are terribly alarmed about the interest cost of the Federal Government, which is now over $9 billion.

Representative PATMAN. That is right, which is almost twice as much as the entire cost for all veterans for all purposes.

Mr. SAMUELSON. Yes. You are greatly concerned about that, but let us suppose that I am also concerned that anything I do about it not hurt an optimal monetary and fiscal policy for growth and reasonable price stability.

I have suggested here that there is one thing that could be possibly done about it, first, the Federal Reserve instead of lowering legal reserve requirements as it has been doing in recent years, could in fact raise legal reserve requirements.

That would tighten up the money market and perhaps it would tighten it up more than was called for in the current situation.

This, however, could be fully offset or could be overoffset by open-market purchases by the Federal Reserve Board of outstanding Government securities.

This would move more of the debt into the Federal Reserve.

However, it would not as a package be inflationary in the way that selling bonds to the Federal Reserve is usually inflationary. But it would have the consequence of reducing the net interest cost to the

Federal Government because, as we know, the Federal Reserve Board is the only organization in the world in the 100-percent-excess-profits bracket.

It automatically chooses to give back to the Federal Government a hundred percent of its earnings beyond its expenses.

So by this device you would, first, preserve any degree of monetary tightness or easiness which you had previously decided upon, and second, you would lower the net interest cost on the public debt.

Representative PATMAN. Your answer there indicates to my mind that you consider the Federal Reserve System not owned by the Government. You talk of it as the only concern that has a hundred percent tax liability. Of course, it is just a Government agency.

Mr. SAMUELSON. I regard it as now owned by Congress. The administration cut its parental ties from the Federal Reserve some time ago.

Representative PATMAN. You know, even Mr. Martin, the Chairman of the Board of Governors, says that banks have no proprietary interest in the Federal Reserve System. The commercial banks, the so-called stock happens not to be stock at all; it is a misnomer——

Mr. SAMUELSON. The spirit of what I have said is not at all inconsistent with your point.

Representative PATMAN. Have you given consideration to the proposal to cancel or to immobilize $15 billion of the Federal securities that are held by the Open Market Committee, the Federal Reserve System.

In other words, the Federal Reserve System now holds $15 billion in securities. Mr. Musgrave from Johns Hopkins stated, and Mr. Smith from Michigan, that they considered the $27 billion really just belonging to the Government, anyway.

One of them said it should not be carried in the national debt that it was owned by the Government.

In other words, when the Federal Reserve takes Uncle Sam's money from the Bureau of Engraving and Printing and trades it for another form of Government obligation, Government securities that are interest bearing, those Government securities are in effect, or should be, canceled; do you agree with that?

Mr. SAMUELSON. Without disagreeing with the spirit of the learned professors whom you just quoted, who are good friends of mine, I should prefer to put it this way:

Men in Congress and the public at large should increasingly become acquainted with the concept of the net public debt. That is the public debt which is really outstanding in the hands of the public and not in the Federal Reserve hands and even for some purpose excludes the debt held for various trust funds of the Federal Government.

If you make that computation you will find that the net Federal debt has been falling.

Far from the burden of the public debt having been increasing in the postwar period, in relative terms it has been decreasing gross, but more than that it has been decreasing even more than that on this net basis.

But I would not choose to burn up the securities in the Federal Reserve. For one thing, I might at some later date want open market sales which would sop up——

Representative PATMAN. Thank you.

The CHAIRMAN. Mr. Curtis.

Representative CURTIS. First, Mr. Chairman, I think for the sake of the record it would be well to put a caveat in there. I think Congressman Patman was the one who testified to the fact that this was unnecessary money. The witness', as I recall it, and I think the record should be reexamined, were quite cautious in their agreements and did not agree with the gentleman from Texas in his conclusions.

The record will show it, but I think it would be well for him to read what the witness has said.

Mr. Ratchford, you brought out a point that I would like to dwell on a minute. You state that:

> The deficit of $2.5 billion in the OASI trust fund in the past 3 years has required the liquidation of an equal amount of Treasury obligations. This came at a most inopportune time for the Treasury and greatly contributed to its difficulties in managing the debt.

The reason I pointed that out is that there are some people who are now advancing the theory that when we consider the problem of managing the Federal debt, we ought to eliminate from our consideration the amounts held in these trust funds.

I have felt that that is a very dangerous doctrine because I think these trust funds, although it is true they are a captive market for Government securities, nonetheless, create an impact that, as you point out, when it occurs points up that this is not outside the problems of the debt management.

I wonder if you would comment.

Mr. RATCHFORD. I think I would agree with what you say if this debt is in the trust fund and stays there we can disregard it.

Representative CURTIS. Except for one other reason I might add. I was going to add this:

We changed the law, and I think rightly so, whereby the interest that the trust fund securities now get is related to whatever interest we are paying in the other sector, Mr. Ratchford. Yes, that would certainly have a bearing.

Representative CURTIS. It is true that if this remains this way; but it is a potential problem and it certainly became a reality, as you have pointed out, and that is the reason I mentioned it.

Mr. Butler's paper, of course, certainly met with my real approval even to the extent of checking off the various recommendations that you were making. I want to point up one or two.

Our unemployment insurance system needs to be improved. I could not agree with it more. We held hearings last year that indicated the areas in which that might be improved.

I have been very much disappointed that the President had no recommendations on that and likewise that the Ways and Means Committee does not see fit to go into that matter. I hoped that it would.

Your emphasis on the need of economic statistics, that our economic intelligence networks need reinforcing, I am in accord with and "we need to prepare ourselves to use fiscal policy with greater imagination, I personally favor cutting taxes in time of recession if I had the assurance that tax rates would be increased when inflation threatens."

We have this to a large degree, do we not, the built-in contracyclical effect in our basic tax structure?

Is what you mean that we ought to have more of it?

Mr. BUTLER. Yes; we have been to some extent quite lucky in the past three recessions. I think it is quite possible that we will face a situation at some future time where we will need a greater stimulus in time of recession than you will get out of a built-in stabilizing effect.

Representative CURTIS. Do you not think about the only practical way though, is that we do build it into the tax structure rather than require specific political action or, rather, congressional action?

I think that is too cumbersome. I do think there are many areas in which we could build more in.

One way would be to put less emphasis on excise taxes at the Federal level.

Mr. BUTLER. There are a thousand ways to do this mechanically, but I do not see much point in discussing the mechanics until one could achieve some general agreement of the desirability of getting ready in advance to deal with a more severe recession than we have had.

Representative CURTIS. I point out that, of course, the unemployment insurance tax to which you refer is a very good example of a tax that is heavy during prosperity and then tapers off during unemployment.

Now, Mr. Samuelson, there are two points I wanted to discuss with you.

One, you state that the theory that we are beyond the point of diminishing returns, as I see it, in taxation, is pretty much nonsense.

I happen to be one who adheres to the nonsensical theory. I think right now we are at that point.

Now, one might question whether we are arguing about whether it is tax revision or actually the amount that we are taking out of the economy; we might not be so far apart although I suspect that even the very amount we are taking out of the economy may be excessive.

I think we could bear more of that, but I do not think we could bear it on the tax structure we presently have.

I have used a few checkpoints to test this; one, of course, is enforcement and the request for additional revenue agents to help us enforce the tax structure, which is essentially a voluntary system, is a real indication in my judgment that we are running to a point of resistance which is extremely serious.

I look to the mergers and acquisitions. There is a normal rate, I guess, if anyone ever studied it, of mergers and acquisitions of smaller companies by the larger, but that rate has been increasing rapidly; and examining into the details of many of these mergers and acquisitions it is the tax structure, I think, that contributes a great deal to the rate.

One of the big arguments before Ways and Means in behalf of H.R. 5, investment abroad, was our tax structure. There is no question but that much of our capital is going abroad not to manufacture for those economies abroad, but to ship back into the United States.

I personally think taxes are only one part of that, but a contributing part.

The problem we are constantly running into is research and development—not getting adequate funds in there and I think has its origin in our tax structure.

The very narrow equity base on which our corporations are financing and the continued emphasis on borrowed capital because of the tax structure are some of the reasons or the checkpoints that I use to support the position that I have made that I think our tax structure is badly undermining the growth in our economy. Any more burden placed upon that structure as we now have it, while I do not say it will collapse, will certainly cause it to sag and I suspect we would not get the revenue.

Now, I have made a little talk. I would like to get your reasons why you think our tax structure or the tax take is not a dangerous situation.

Mr. SAMUELSON. Let me first say that the position under discussion is not whether we are in the realm of diminishing returns. I learned the law of diminishing returns from a profound economist many years ago and I have taught that law since. Professor Douglas was my teacher.

The CHAIRMAN. You have far surpassed the original instruction.

Mr. SAMUELSON. Let me simply say that every farmer since the beginning of time has been operating inside the law of diminishing returns. The more relevant question would be not whether a Missouri farm in applying more labor to it is reaching the state of diminishing returns, but whether you have gone so far that not 1 more bushel of corn can be squeezed out of it, whether or not one more penny of taxation, that sort of limit.

Now, it is that type of limit that I am speaking of.

Admittedly everything in the economic life has its cost. As I review the arguments you have made they simply bear on the fact that a tax has a cost, an additional tax has a cost. Nobody has denied that.

To go back to my original remark, if you thought that we needed more missiles, a better space program and so forth, the fact that there would be additional costs on the tax front should not be guiding.

Now, in earlier discussions it has been guiding. I will quote to you what an elder statesman used to say: "Inflation is more dangerous than Stalin."

As I understand, that embodies an economic hypothesis. Although I am not an expert on space and military missiles I think an economist can comment on that, and for that to be true it would have to mean that the extra taxation which might be needed for extensions as were proposed of these programs would in fact be so great as to weaken the country more than these programs would strengthen it.

That I question.

Representative CURTIS. There is one thing I was most happy to hear you say on which I could not agree with you more, that is if we do need to spend more on that we had better get the taxes.

With that I will go along.

The question I am raising is whether or not our tax structure is such that we can impose more taxes on it without creating very serious economic damage that will hit us, not tomorrow or the next day, or next year like the failure to provide the adequate military weapons would. That is why I say on the immediate problem I agree with you.

But I say in looking at that it is important to examine whether or not imposing taxes on what we already have and in a structure sense whether or not we are going to create these damages.

That is the area in which I am deeply concerned. I personally do believe our tax structure now is undermining our economy.

The CHAIRMAN. Congressman Bolling.

Representative BOLLING. I would like to come back to this letter in the Post by Mr. Means. He in effect says that increase in the interest ceiling or elimination of that ceiling on long terms might saddle the taxpayers in effect with 30- or 40-year burdens. That is his position.

Then there is another point he made and that is that one of the dangers of eliminating the ceiling is not so much what the economic effect would be, but what the psychological effect would be on those who invest in such bonds.

In other words, the problem of expectation. An illustration of this in another field has been what has happened to the availability of money in certain types of housing, let us say FHA, VA, when the expectation of the people who lend this kind of money in large chunks was that Congress was going to lift the ceiling.

The best illustration that I know of is when in the early fifties the Congress put in a legal limitation on the number of points in the discount on a housing transaction.

The story we got was that the money dried up and disappeared because they did not feel that this could be sustained and the next year as I remember it we repealed that particular provision of the law.

I would like some specific comment on the soundness or lack of soundness of Mr. Means' point and some specific comment on this business of what is the impact of this expectation question.

I am sure that the witnesses know this. I have been in a very awkward position on this interest ceiling never agreeing entirely with anybody much.

I would like comments from as many of you as would care to comment.

Mr. GORDON. I shall be quite happy to start, Mr. Bolling. I think to some extent we have been addressing ourselves to the wrong problems and the wrong symptoms.

I read Means' letter this morning in the Post and I must say I do not agree with his argument. The problems that we are worrying about and he is worrying about have been largely created, I think, by the Federal Reserve and the Treasury.

We are worrying, I am one of those who is worried, about the attempt to use a tight monetary policy as a means of controlling inflation. I would be happy to see the Federal Reserve ease up.

I would also like to see it have a more flexible policy with respect to open market operations and not buy and sell only on the very short end of the maturity range.

Nonetheless, it seems to me, we ought to give the Treasury maximum flexibility in managing the public debt and not hamstring it.

Now, am I correct in the assumption, to take one point that Means raises, that the Treasury, like any corporation, has the right if it wishes to refund in time of low interest rates outstanding obligations originally issued at high interest rates?

51708—60——28

If so, then Means' argument that you are saddled with a 4½- or 5-percent interest rate on a 20- or 30-year bond for the full 20 or 30 years does not hold.

Nor is it true, as he suggests, that any conservative adviser to a large corporation would advise that corporation never fund short-term debt into long-term debt at a time of high interest rates.

Considerations of financial solvency frequently require that a lot of floating debt incurred by a private corporation, let us say a large utility carrying through a continuous large-scale investment program, be regularly funded into long-term obligations.

More than one large utility has had to put out 4½ and 5 percent long-term bonds. Many of these will in some future period, with lower interest rates, be refunded into lower coupon bonds, just as occurred in the period of 20 or 30 years of easy money that we had.

So it seems to me that we ought to give the Treasury the opportunity to refund, to manage the public debt in a systematic way, and at the same time, in whatever ways are possible, try to convince the administration and the Board of Governors of the Federal Reserve System, that their policy with respect to the attempt to control inflation through an overall tight monetary policy is mistaken.

Representative BOLLING. Would you care to comment on this expectation? Has it any validity at all?

Mr. GORDON. I don't think in this case that it does, if I understand your question correctly.

It seems to me that if we were to take the ceiling off and the Treasury were free to issue bonds with maturities beyond 5 years at rates from 4¼ up—I am guessing but I don't think that it would have a violently unsettling effect on the long-term capital market.

Representative BOLLING. Thank you.

Mr. SAMUELSON. Let me first say that there is one part of Mr. Means' letter that I can agree with.

One of the arguments that has been going around for raising the ceiling, and it is not the argument upon which my recommendation was based, is that it will save you money by virtue of the fact that today, or just recently, you had to pay 5 percent on a 4½-year issue or on a 1-year issue, whereas the long-term Treasury curve was actually lower, let us say, instead of 5 percent, 4½ percent.

As any fool knows, there is a difference of one half of 1 percent there.

Ergo, if you issue long-term debt you are going to save that one-half of 1 percent.

Means has hit that argument right on the head.

The problem is not what you are going to save in the next 6 months. The problem is what you are going to save over the cycle as a whole if you behave one way or the other.

His point there is very well taken. That does not mean that I would rescind my recommendation at all, because nobody knows what is high and what is low in interest rates.

We are not in a Nevada casino where the dice always fluctuate on the average between certain ranges.

We know in history interest rates have had long years when they have gone up and they have had long years when they have gone down.

I do not know, as Mr. Means seems to think he knows, whether for the 20 years ahead these are low rates or not. And many a borrower who has postponed coming to the market because of "high" interest rates has later had to pay even more.

What I do know is that given a rational Treasury, given the freedom to sell bonds across the spectrum, a freedom which I shall assume is exercised prudently, that the chances are with the same degree of inflation control, with the same degree of percentage of full employment attained, you will save a little something if the Treasury has the right to sell across the board rather than to sell at the bottom.

In fact, you are imposing a "bills only" doctrine on the Treasury, you might say.

The CHAIRMAN. That ought to meet with the approval of Mr. Martin.

Mr. SAMUELSON. I have no comment there.

With respect to the announcement's psychological effect, I would simply remind you that the future is longer than the present.

I prescribed a repeal of the gold 25 percent backing. Now I know and you know that some Zurich bankers, some Frankfurt bankers, fleeth where no man pursueth.

On the day that announcement comes out they will start pulling out some money.

More than that amount of money will come back later.

I haven't the slightest doubt in the world that when Mr. Dale publishes in the New York Times that the 4½-percent ceiling has been repealed by you wise people, that the bond market is going to take a drop that day and the man who goes around looking for a mortgage on just that particular day might find it tough.

But that will pass. It is remarkable how quick the fundamentals, I won't say of spontaneous supply and demand, but the fundamentals of the marketplace plus Mr. Martin will reassert themselves in the situation.

Representative BOLLING. Mr. Chairman, I have run out of time.

The CHAIRMAN. Mr. Kilburn?

Representative KILBURN. I have no questions. I did not hear the statements so I will pass.

The CHAIRMAN. Senator Sparkman.

Senator SPARKMAN. Mr. Chairman, I want to go back to the question that Congressman Patman asked. I think it is a rather intriguing question.

I would like to hear Mr. Samuelson's comment, that is whether or not a higher rate of interest stimulates, brings in more savings?

Mr. SAMUELSON. This is a very difficult economic problem. It is one that I personally have wrestled with for 20 years and economists have wrestled with for 120 years or more.

If you apply analysis to the problem it can go either way.

If a man is offered higher interest he has a greater incentive to save. On the other hand, if he is saving for his old age, for a picnic, for some specific purpose, he has less need to save if the interest rate is higher.

So it is a standoff with respect to the analytics of the situation.

Let us turn to every budget study that has been made, let us turn to every statistical analysis of time series that has ever been made by anyone.

Again it is very hard to find a significant answer one way or the other to this question. Lots of people save automatically. People save for power, for thousands of different reasons.

So sometime ago I would have been inclined to answer your question by saying we don't know and the presumption is since we don't know, and cannot find out, the effect cannot be very strong one way or the other.

I do want to throw in one bit of evidence, however, which might change the position a little.

There are a number of countries that have gone through steady, extensive inflation. Now, I am not thinking of creeping Slichter inflation.

I am thinking of the sort of thing you see in Chile or in Brazil where a man never saw the price level go down, his father never saw the price level go down, and his grandfather never saw the price level go down.

This is equivalent to changing the real interest rate on savings downward because the market never fully adjusts to this situation. I think there is some evidence that in those countries there is an undermining of the motive to save.

So I would bring that point up.

I would also bring up another point about which there is little doubt. Namely, that one of the sources of saving, in fact that is what compound interest is—the interest on wealth. There is not any doubt that the higher the yields and the higher the interest, and these accrue by the way, not to the easy spenders but to the Victorian thrifty people, that they plow back more if they have more.

So in view of those two situations I would say that probably there is a small tendency for an increase in interest rates to increase the effect of saving a little bit, but that is much, much weaker than the investment effects of monetary policy.

Senator Sparkman. Do you think that it would not be highly important.

Mr. Samuelman. Not highly important.

Mr. Gordon. Senator Sparkman, may I interject one comment which has just occurred to me.

I think there is a way in which in the short run high interest rates may be associated with a change in savings. I have been rather impressed by this factor in the last few years.

Let me emphasize I am speaking about the short run and about effects associated with high interest rates. High interest rates go with restricted credit availability. Anything that makes it more difficult for consumers to incur debt has an effect on savings.

One of the most important factors associated with the quarter-to-quarter or year-to-year changes in the amount of personal savings in recent years has arisen out of the willingness and ability of consumers to incur more personal debt.

Senator Sparkman. By the way, we are in a high interest period now. I think most of us will agree to that.

We are in a tight money era. The building industry, particularly homebuilding industry, has felt it quite keenly.

The homebuilding is generally done out of the savings and a particular field of savings.

Now, if high interest rates encourage savings why do we have this tight situation in the field of homebuilding?

Mr. RATCHFORD. I think one point there may be, Senator Sparkman, that the demand has increased even faster than the supply.

Senator SPARKMAN. I would agree with Professor Samuelson that the effect on savings is not very great and if the demand in this field increases even faster, why, we get the higher rates.

Mr. RATCHFORD. May I add just one point very briefly.

Senator SPARKMAN. Yes.

Mr. RATCHFORD. As I indicated I would agree that higher interest rates would not have a great effect on savings. It might have an even greater effect on making funds available. I refer to the practice of corporations in managing their funds, which has been commented upon by a number of writers.

When the short-term interest rates are one half of 1 percent, they make no real effort to put their short term, unneeded funds to work.

It has been demonstrated in recent years that they do it on a large scale when they can get 4 or 4½ percent.

I think that has an important bearing on this question.

Senator SPARKMAN. I might ask a similar question in a little different language.

For instance, does an increase in interest rates check capital spending, and if so, what kind and by whom?

Mr. RATCHFORD. If it did not, Senator, there would certainly be no basis for objecting to high interest rates.

Certainly if the funds are limited, that is going to cause rates to go up and somebody is going to have to do without.

Those who do without are the ones who restrict their capital spending.

Senator SPARKMAN. But the whole thing again it seems to me to be contradictory. Because if you increase the incentive to save, the more money you save the more money becomes available for spending.

Now, what happens to it? It is spent, is it not? I cannot quite follow the circle around.

Mr. RATCHFORD. When we speak of demand we usually think of demand for consumer goods. If you save and increase your supply of capital goods you then make possible an increased supply of these capital goods, to meet the increased demand, and if that works out in proportion there is no necessary reason for a price advance.

Senator SPARKMAN. I will not belabor the point further. The time is short.

There is another question I want to ask Mr. Samuelson:

In your statement you said, in talking about the removal of the 4¼ percent, you say:

> I ought to point out that the interest ceiling is not the vital issue that Wall Street journalists purport to believe.

Just what do you mean by that? Do you mean perhaps it is not so important after all?

Mr. SAMUELSON. Well, it is like the man in the bar with a ball and chain. Another man says "Doesn't that slow you down and hamper your walk?" and gets the answer "No, it is just a little ball and chain."

Well, the 4¼ percent limit now is not very far out of line with what would prevail under market conditions.

On the other hand, the history of, let us say the period of the Napoleonic wars and earlier period shows what dreadful harm a ceiling can do when actual market interest rates are way out of line with imposed ceilings.

In this connection I want to mention while we have our knives out for all kinds of ceilings. One reason that funds are short for housing is because you have a ceiling on FHA and you have a ceiling on VA loans.

Senator SPARKMAN. I have heard that argument so many times. Why is that true? The ceiling on FHA is 6 percent and FHA has never raised the rate up to the ceiling.

Now, why does the maintenance of a 6-percent ceiling, which is over and above the FHA rate, why does that affect money supply for FHA mortgages?

Mr. SAMUELSON. That does not.

Senator SPARKMAN. All right.

Remember, the ceiling there that Congress fixed is above the FHA rate.

Mr. SAMUELSON. The ceiling which is now set by FHA is one of the best ways of drying up the funds to the lower income groups who could benefit most from FHA.

Senator SPARKMAN. I would certainly argue the point with you. I think about the low income people being hurt by reason of the fact that they are not able to pay a higher rate of interest.

I do not think so. I think a great many of them are being denied housing today because of the high interest rates, but we do not have time to argue that point now. My time is up.

Mr. GORDON. May I make a comment on this, Mr. Chairman?

The CHAIRMAN. Yes.

Mr. GORDON. Here, as in many other areas, we have to make a choice between objectives. It is true that the present tight money is preventing the building of as many houses as might otherwise be built. This is happening because of interest rate ceilings.

But let us also remember that a very effective stabilizer that the Government has created has come from just this fact, and in the last two complete cycles, housing has acted almost in a contracyclical way.

If we are prepared to defer some residential building in boom times because of this mechanism about which we are talking, we seem to be able to get it in recession years and thus end recessions or at least ameliorate them in a way that would not otherwise occur.

While personally I regret the fact that some people don't get their homes as quickly as they would want because of this, I welcome the stabilizing effect that this process has created.

The CHAIRMAN. Dr. Gordon, I was much interested in your statement that you thought the present financial problems about which the Treasury complains have been primarily created, not by the legal ceiling, but by the policies of the Federal Reserve and the Treasury.

I take it that you meant that the Federal Reserve had pursued an unduly restrictive money policy and had kept interest rates up above what they would have normally been and that the Treasury in its fiscal policy has been defective in possibly its debt management policy; is that correct?

Mr. GORDON. Yes.

The CHAIRMAN. I agree with that. That was the burden of our majority report.

Now, you say, however, that what we should do is to lift the interest ceiling and then make an appeal to the Treasury and to the Federal Reserve to change their policy.

Suppose they do not change their policy? In fact, we have been urging them on these points for many months since the hearings of last year with no indication of any change whatsoever.

We have had Mr. Martin back again just a couple of days ago. He reaffirmed his policy.

Now, suppose we say, "All right, we will lift the ceiling." We pass that, then we say to him, "Be a good boy, put in these reforms." They say, "Thank you very much, but we think this is unwise."

Mr. GORDON. I am afraid that I am likely to get into an area in which I am completely incompetent at this point, namely, the political one.

The CHAIRMAN. Now, you may remember that Adam Smith dealt with this issue in connection with tariffs.

Mr. GORDON. If there were a succession of administrations which insisted upon such a tight money policy, Congress in its wisdom could do a number of things, including, among others, changing the instructions they gave the administration, for example, in the Employment Act.

I have suggested previously before this committee that the President's Economic Report is deficient in its failure to make suggestions on the subject of monetary policy, a subject which I understand is before the Congress.

It seems to me that there are various ways, both through consultation and by legislation, whereby pressure might be put on the administration to give us an integrated, better articulated monetary-fiscal policy and one more conducive to the kind of overall program that I personally am advocating.

The CHAIRMAN. Is it not true that the Federal Reserve could change its policies virtually without legislation? It could announce that hereafter it intended to increase the money supply at a rate approximately equal to the rate of increase in the gross national product, that it intended to do so by open market operations rather than by lowering reserve ratios, and that the Treasury on its side could say that they would use fiscal policy to a greater degree as a contracyclical weapon, that they would issue callable bonds, which they have thus far refused to do, and introduce other reforms in debt management; that they would make their issues more competitive, using the auction system rather than the fixed interest, fixed price system?

Do you not think that would really strike at the difficulties?

First, would you think that would remove most of the difficulties?

Mr. GORDON. May I answer indirectly?

The CHAIRMAN. Certainly.

Mr. GORDON. It seems to me we have two alternatives and you are expressing them. We can do what I suggested first and which apparently did not satisfy you——

The CHAIRMAN. No, I did not say that.

Mr. GORDON. That Congress and its committees work in whatever ways are possible to bring about a change in the policy set by the administration and the Board of Governors.

Now, another alternative, which I think has been implicitly suggested here, is that Congress make it so tough for the Treasury to administer its affairs that it will be forced to adopt an easier money policy, that is by keeping the ceiling you make it so difficult to manage the public debt that the Federal Reserve will have to bring down interest rates and then the ceiling would no longer be important.

I leave it to the much superior political jugdment of the Congress as to which it wants to do.

The CHAIRMAN. In other words, you remember Adam Smith faced this same issue. I think he was quite correctly for a low tariff policy or free trade between countries. He says, and I paraphrase him,

> Suppose country A is a lower tariff country, country B imposes higher tariffs. How are you going to get country B to lower? Should you immediately lower your tariffs in order that your example may spread and you may change the hearts of the others, or should you keep up a higher tariff and say, "Well, if you will reduce your tariffs we will reduce ours."

He concluded with that famous sentence that this task depends upon:

> * * * the skill of that insidious and crafty animal, vulgarly called a statesman or politician, whose caveats are directed by the momentary fluctuations of affairs.

While he threw in the epithets about the politician he called on this crafty and insidious animal to settle something that was too difficult for an economist to solve.

Mr. GORDON. I am doing the same.

The CHAIRMAN. Which is apparently your conclusion. It is too difficult for you to solve so you say let the politician settle that.

I happen to be one who does not believe in unilateral disarmament. I do not believe in one side disarming without some pledge from the other side.

Let me say this: I think if we got assurance from the Federal Reserve Board that they would put in reforms in monetary policy and from the Treasury that they would put in reforms in fiscal policy, that the interest ceiling as you say, the legal question would be academic and personally I would have no strong objection to removing it if we had bona fide reform.

But we have been pushing on this question for almost a year with no results.

The Reuss-Metcalf resolution, which was a very mild resolution; namely, that in general the reserve should expand the money supply and do it by means of open market operations, was rejected by the Chairman of the Federal Reserve Board. He has appeared again and again before us and adopted the same position.

There is not the slightest sign that the Treasury is proposing or would agree to any reforms.

Now, do you think we should surrender the one weapon which we have and throw ourselves upon the charity and public spirit of the Treasury and of the reserve. Or should we have a certainly manly dignity and say, "Well, it is your move; it is your chance to do something, show that you are willing to cooperate and then we will talk with you."

Mr. GORDON. I think more is involved here than merely the traditional unwillingness of a professional economist to speak on political or policy measures.

I might, Senator Douglas, even plead the fact that I am not only an economist, but I live 3,000 miles away from Washington.

Obviously it has to be the judgment of the leaders in Congress in handling their relations with the administration. Let me say simply that I regret the fact very much that there seems to be on this subject almost, shall I say, open warfare between at least a large segment of Congress and the administration, and I regret also—to come back to the subject of discussion this morning; namely, the Economic Report of the President—that such an important document could have been written in January 1960 and give so little evidence that those who wrote it are sensitive to both the studies that have been going on in Congress and the debate on these issues that is going on both in Congress and among professional economists.

The CHAIRMAN. Mr. Samuelson, would you express yourself? I may say that I played only a very small part in Mr. Samuelson's intellectual development. He moves on his own.

Mr. SAMUELSON. Let me first say I am not competent to judge tactics, but I would remind you that when two people war, there may be a third party whose interest is also affected.

There could come a time, I don't think there is any crisis now, when the use of a ceiling as a symbolic gesture and as perhaps a punitive measure could do harm to the American public.

Then you would have to weigh the——

The CHAIRMAN. Do you think the policies of the Federal Reserve and Treasury are doing harm to the American public?

Mr. SAMUELSON. Well, I have stated criticism of certain aspects of the policy, but may I address myself to one question that bears upon this?

Professor Gordon has been speaking about the relationships of Congress to the administration. Now, a certain set of separation of power and checks and balances is part of our political system. I would like to address my remarks to the relationship of the Federal Reserve to Congress.

As you know, the Radcliffe report has come out strongly for what is already the case in U.K., which is the mother of central banking; namely, that there is to be a unified monetary and fiscal policy, the unification taking place within the Cabinet which is the executive branch of the Government.

Apparently in recent years the American solution to the problem has not been that, namely, the Federal Reserve is an independent Federal Reserve.

I have no criticism of that.

To have anybody breathing down the neck of the Federal Reserve in its day-to-day operations would be a horrible thing for the country. To whom the Federal Reserve is responsible that group should have a self-denying ordinance with respect to minutiae of policy and day-to-day operations.

On the other hand, it is unthinkable there could exist a kingdom inside the Republic of the United States which is answerable to nobody.

So the general agreement is, I believe, that the Federal Reserve is in the last analysis answerable to Congress.

Now, it is perfectly clear that there are some Members of Congress in both Houses who do not agree with what the Federal Reserve has been doing. I wonder whether in terms of overt action it is clear that the Congress as a whole is disapproving.

If so, they are derelict in their duty to make it clear in unmistakable terms. We don't have a czar Biddle in the country who is making unilateral decisions on his own and nobody in the Federal Reserve System thinks that.

The CHAIRMAN. You suggest three things, resolution, moral suasion, and legislation. We have used moral suasion to no effect.

What remains is resolution or legislation.

Now, I take it you would not object to a sense of Congress resolution?

Mr. SAMUELSON. On the contrary, I have said that in my view a bill only does more harm than it does good, and if Congress agrees with that view and if the Federal Reserve does not, it seems to me it is the duty of Congress to make clear what ought to be done.

The CHAIRMAN. Would you also feel that it would be proper for Congress to say that the secular increase in the money supply should be effected by open-market operation rather than by the lowering of reserve ratios?

Mr. SAMUELSON. I have not made any such recommendation and I should not like to have a one-man majority in Congress telling the Federal Reserve what it ought to do in terms of fundamental policy.

But if there was a strong conviction in Congress that this was the appropriate policy, I think Congress would be derelict in its duty in giving, shall I say, leadership and direction to its ward, the Federal Reserve.

The CHAIRMAN. I have heard rumblings from my right and I think they should be given the opportunity to be articulate. So, although it is not precisely Congressman Curtis' turn, I will be very glad to give him 10 minutes and then Congressman Patman.

Representative CURTIS. Thank you, Mr. Chairman.

I was so pleased to hear what I thought was a very clear statement by Dr. Samuelson, of at least my conception of this problem, especially the political aspects of it.

I do not know that we agree on the economics, but that is an area in which I am not an expert.

The reason I was uttering noises over here to your right, Mr. Chairman, is that when he said that we have used moral suasion, I was just wondering what he meant by "We."

It is true that a certain segment of the Congress in both the House and the Senate has been using it, but there have been others who regard it as immoral suasion and we're trying to use whatever suasion we can the other way.

So there is one way of resolving things in Congress, of course, and that is to bring it to the proper committees—the Banking and Currency Committes of both Houses, not the Way and Means Committee as has been the attempt because it is not in our area, and our staff is not trained in that although banking and currency is—and bring it out on the floor and let us have it.

There is one question I would like to ask Dr. Samuelson. Maybe we can clarify some of this. It is, frankly, this monetary thing; I am listening primarily because I do not know very much at all about it.

But in listening to Mr. Martin he made it quite clear, I thought, what he regarded as the mandate from Congress to the Federal Reserve. It was a rather single one, which was to preserve the integrity of the dollar.

It seems to me the criticisms are directed by people who think that the mandate is different than that. But if you granted Mr. Martin his premise, just for the sake of discussion, that that is what the Federal's control would do, I wonder whether the criticism then would be just.

So the question, if that is so, would resolve around what has the mandate of Congress been to the Federal Reserve? Is its concept of that adequate, or indeed, has the Congress told the Federal Reserve to do other things than that?

Mr. SAMUELSON. I am not a constitutional historian and I don't know the history of all the conversations that have taken place on paper or orally between Congress and the Federal Reserve.

I can report on what is the great tradition of central banking which goes back years and years.

I do not believe that the great tradition of central banking as practiced in the democracies of the world today or in the past has been any exclusive concern with one goal.

Moreover, from the economics viewpoint there was a very sad cleavage years ago based upon faulty economic analysis that somehow monetary policy operates on P, the price level, and fiscal policy somehow operates on employment and output.

Economic technicians know better than that. Both act upon both. So I would say that the mandate of central banking as it has ordinarily been understood in the past, certainly by economists, is to contribute toward overall stabilization of the pluralistic goals which are involved.

Having said that, let me say I can sympathize with the Federal Reserve Board if it occasionally felt that it was the only group left in the community whose heart really bled about the price level and if it conceived itself on occasion in the role of little Peter at the Dike with his thumb in; and I can see how it might argue in a pluralistic economy other people are unduly neglecting under this price goal, so it might be their function to overemphasize it.

Representative CURTIS. I think from what you have said and from what I have heard Mr. Martin state constantly, that therein lies what difference there is and it looks like it is fundamental.

Unless I have misunderstood him, he does not share that concept of what the central banking—at least our central bank, the Federal Reserve—should be doing.

As I gather, and I thought he said it quite emphatically, he regarded that primarily its function is to preserve the integrity of the dollar.

He did say this, however, that if in carrying out its primary function it can be helpful in some other way, it will try to do it. But it has to keep its eye on that one thing.

Now, I think we can have a very good discussion if that is the difference and it could be very meaningful because if he has that conception and the Congress and the country thinks that the central bank, as we see it in this country, should be other than that, let us examine into the thing.

But I don't want this constant confusion and misquoting of Mr. Martin's position, which I have been listening to now for the past year until I am sick of it.

He has made a statement. He has tried to make it clear. Now, if there is a disagreement on this fundamental purpose of the central bank, the Federal Reserve, let us have at that and we can get somewhere maybe.

Mr. SAMUELSON. May I ask a question?

Representative CURTIS. Yes, certainly.

Mr. SAMUELSON. I have not followed every utterance of the Federal Reserve, but I have been a reasonably assiduous student of their remarks.

I cannot recall any occasion when the Federal Reserve has said: if it should be the case, and we, the Federal Reserve, do not think it is the case, that stability of the dollar could only be achieved, let us say, by creating monetary conditions which would lead to 6½ percent unemployment, we still conceive it to be our function to preserve the stability of the dollar——

Representative CURTIS. I almost think that they are saying that. If they are, then we have to evaluate that.

Mr. SAMUELSON. If that is the case, and if Congress has any doubt about it, I should think it would be in the interest of Congress to get a clarification of that matter.

Representative CURTIS. I think that is where we are.

Incidentally, I might state, just to show that it is not a callous position, you create a tool for one purpose and maybe you can make it a dual purpose tool. That does not mean that you do not want to have a tool to take care of the other, too.

In other words, because we might say, and I am not saying that we are, that the Federal Reserve should not be concerned about that, that does not mean that the Government in its entirety should not be concerned. It is simply that we would treat the unemployment factor and difficulty in another area, and we would not attempt to treat it through manipulation of money which, incidentally, I happen to think is right.

Mr. SAMUELSON. What would you think of a team of doctors in an operation and one of them says, "Now, I am the arterial man"; the other man says, "I am the vein man," hoping that out of the clash of adversary procedure the patient would receive optimal treatment.

Representative CURTIS. Whether your metaphor is good, I would view it just like this: I would hate to have a heart man messing around my legs.

I would not think it would be wise. Of course, to me, if we are going to measure economic phenomena, we are going to keep the balance between services, values, and generations, we are going to have to try to have a measuring stick which is not elastic.

To me it is a very fundamental thing.

Now, whether you have to devote one big agency like a central bank to that one objective and not let it mess around in other things, that is the issue, as I see it.

I honestly do not know enough to draw a conclusion now. I am trying to put out in the open what I think is the argument, the area of disagreement, where the public discussion should be.

I think it should be there.

I suspect the Federal Reserve, at least under Mr. Martin, would answer "Yes" to you on that question of unemployment, that that would not be the Federal Reserve's job, that somewhere else in Government we would have to meet that problem.

Mr. GORDON. May I make a comment on that, Mr. Curtis.

Representative CURTIS. Certainly.

Mr. GORDON. Actually two comments.

If you go back into the history of the legislation creating the Federal Reserve System and the earlier years in which the Federal Reserve was formulating its policy, I think you would have to agree that protection of the integrity of the dollar, or simply maintaining price stability, was not the primary objective.

Actually, the Federal Reserve System was set up after 15 years during which prices had been rising at about the rate they have been going up during the last decade. I do not recall that the original Federal Reserve Act said that stopping that price rise was the reason why the System was being created.

Further, when the Board began to formulate a policy, beginning in the early 1920's, there were a complex of objectives stated.

Further, in either 1926 or 1927, when hearings on price stabilization were held, it is my recollection that the authorities in the Federal Reserve System opposed an attempt to impose a price stabilization objective on the Federal Reserve System. It is my own feeling that, whatever the emphasis put on the various objectives, Congress intended and the Federal Reserve Board itself believes that it does have a set of objectives, of which price stability is only one.

But it seems to me that the primary issue about which the debate ought to be waged is not where in this hierarchy of objectives price stability comes. The debate ought to be waged on the question, can monetary policy be as effective in stabilizing the price level as apparently the Board believes it can in the kind of world in which we now live.

I would take the position almost categorically that here the Federal Reserve makes a serious mistake, that even a tighter monetary policy that the one it is now pursuing would not stop the rise in prices.

Representative CURTIS. I am going beyond my time but I think, as I have listened to them, they have recognized that with the increasing substitutes for money, this problem of control is exceedingly difficult. I do not think they have any illusions about the ability with which they can do the job which they think is their job.

I think they recognize that they have severe limitations, which is another thing that I think we ought to think about in trying to decide what we want to do with this central banking system, that is if you want to change it.

Thank you, Mr. Chairman.

The CHAIRMAN. Congressman Patman.

Representative PATMAN. I want, later on, to ask Mr. Butler some questions about the depression, but first I want to discuss the Federal Reserve since it has come up in our discussions.

I hope we keep in mind that the Federal Reserve System that was organized in 1913 is an entirely different system than the one we have now. When we had the regional system in 1913, President Wilson was determined that bankers would not be on policymaking boards. In fact, he in effect gave an ultimatum to Congress that he would not approve any bill that would permit bankers to be on these policymaking boards.

When the bankers, with Senator Carter Glass of Virginia, visited him in Atlanta and they were trying to convince him that bankers should be on these policymaking boards, according to Senator Glass, President Wilson turned to them and said, "Now which one of you favor the owners of railroads being on the Interstate Commerce Commission to fix railroad passenger and freight rates?"

Senator Glass said in his book that it was the longest minute he ever experienced in his life and they did not have any answer; they got up and left.

That policy was carried on for more than 22 years and the view of Woodrow Wilson prevailed. But in the depression from 1933 to 1935, when Congress was not looking because we were all trying to get out of the depression and we were willing to do anything, the Federal Reserve Act was substantially and radically changed to the point to where we have a central banking system now as distinguished from a regional banking system under the 1913 act.

Now, not that I disagree with the central banking features, I do not; I am in favor of central banking. I think it has worked in other countries, too. But the point is that, in making these changes I do not believe we kept in mind what President Woodrow Wilson said was necessary, and we permitted private bankers to get on policymaking boards.

We created the Open Market Committee for the first time composed of seven members of the Board of Governors and five representatives of the private commercial banks. Now that does not sound so bad, but one should take into consideration the fact that they are engaged in carrying out the will of Congress under the Constitution. They get their power from Congress, and exercise a governmental power, but there are some people on that Committee who have other axes to grind.

It has been suggested that Congress take back that power from them, giving them the other powers that Congress has, and the country would be better off, since they now have more power than Congress. I think there is a lot to support that view. But that is not all.

How can we expect the members of the Board of Governors to be influenced by the will of Congress—the representatives of the people—when Congress has placed them in an almost impossible position?

These seven members, representing the public, are appointed by the President, confirmed by the Senate. They have long terms; 14 years now. They are, of course, insulated against public sentiment to a large extent. Not only that, Congress has surrounded them with 24 representatives of the private banks that help them perform their duties. Now when they have a meeting of the Open Market Committee, they

do not just have a meeting of those 7 members of the Board and 5 representatives of the banks; the 12, they do not meet there together. They have the 7 members of the Board and 12 presidents of Federal Reserve banks, all of whom are selected by the private banks, in this room here in Washington. There are 19.

Not only that, but Congress has imposed upon these public members an obligation to consider the Federal Advisory Committee members. Each one of them is appointed by the private banks in each of the 12 Federal Reserve districts. So they are, of course, "in there pitching," too.

So Congress has caused these 7 public members of the Board of Governors to be surrounded by 24 representatives of the private banks in the performance of their duties.

Have we not placed them in an impossible position?

Should we not place them in a better position where they can exercise their own judgment without pressure from those who are financially and otherwise interested in higher interest rates and tight money and sometimes even hard times, or should we have only people who are interested in the public on these boards to perform these duties?

I wonder sometimes if we have not made captives out of the seven members of the Board of Governors. What would happen if they seriously took issue with these 24 representatives of private banks?

I think truly and really the Federal Reserve can be considered in this country a sacred cow. It is a sacred cow in every sense of the word and Congress has been derelict in its duty, I think, as suggested by Mr. Samuelson, in its failure to do certain things that it should do.

In a democracy and a parliamentary government such as our own, there is no one in the Government, not even the President, who can formulate future policy and laws; there is nobody who can say yes, but there are a lot of people who can say no.

We have not had a real investigation and study of the monetary system in this country for 50 years. That is the reason that some of these things were gotten in our laws.

Very few people know that our Federal Reserve System operated just like having the railroad owners on the Interstate Commerce Commission fixing the railroad freight rates, but that is what we have. We have bankers on these boards and they have axes to grind.

We should not put these seven members of the Board of Governors in the position of helping or standing by while the representatives of private banks grind their axes. As long as we do that, we are not going to have low interest and we are not going to fail to have tight money.

Mr. SAMUELSON. Can I make a minor correction in the record?

Representative PATMAN. Yes, sir.

Mr. SAMUELSON. In my oral testimony I said that if a consensus existed in Congress with respect to a policy different from that pursued by the Board, then I would think it was derelict in its duty if it did not give leadership and direction to the Board.

Representative PATMAN. I thoroughly understood what you said, but it was a very fine suggestion, not very well veiled, that we should do things.

Mr. SAMUELSON. And I made a specific recommendation with respect to bills only.

Representative PATMAN. And I agree with you. I think it is terrible. We have almost a dictatorship in the Federal Reserve System and I think it is due to the fact that we got away from ideals of the Federal Reserve System.

Mr. SAMUELSON. Let us make clear: You think it is terrible and you think it is a dictatorship?

Representative PATMAN. Yes.

Mr. SAMUELSON. And on some other matters, we agree.

Representative PATMAN. On other matters? Some of them I do; some of them I do not. If I had your knowledge I might agree with you. You have more knowledge on this thing than I have.

Mr. Butler, you stated here: "On the postwar business cycle pattern, one would look for another recession starting in 1961."

You have given us a lot of suggestions for consideration. That is one of them. Do you anticipate a serious, rough depression, or do you anticipate one that is not as bad, say like 1949–50 or 1957–58?

Mr. BUTLER. I don't know of any way to answer that question with precision at this time. I think much depends on what happens in this year and early next year.

I think one cannot talk in knowledgable terms about the possible severity of a recession this far in advance until we see how things go along. It may be possible later on to make some judgment as to the severity of the next recession.

Representative PATMAN. You say: "There is no way at present to predict just when it might come, but the odds favoring a downturn will lengthen as we move through 1961."

Do you think high interest rates contribute to this outlook of a depression?

Mr. BUTLER. I think high interest rates and tight money are one of the many factors that influence the business cycle.

Representative PATMAN. In other words, in looking into the future as you are, and seeing that we are likely to have a depression in the next year or two, you think that tight money and high interest will be somewhat the cause of it?

Mr. BUTLER. I will put it this way. If interest rates were lower, I would not change my forecast.

Representative PATMAN. You would not change your forecast?

Mr. BUTLER. That is right.

Representative PATMAN. Now you are a man who knows a lot about this that I do not know, and I want to take this opportunity to ask you about it.

Do you not believe that the Federal Reserve in 1953, for instance, in starting out in its policy with the new administration, if it had been determined to do so could have kept interest rates low and at the same time effectively fought inflation rather than making interest rates high by using other weapons that the Federal Reserve has at its command? I refer particularly to raising reserve requirements and I refer to discount rates and I refer to market operations. I refer to the ability of the Federal Reserve to immobilize reserves when they want to.

Why could they not have used one or more of those weapons and kept interest rates low instead of just every time a decision was made decided high interest, high interest to fight inflation, and more high interest to fight inflation?

Do you agree that other weapons could have been used?

Mr. BUTLER. I would agree that other weapons could be used. I do not think they would have much effect on the interest rate so long as they are used toward the objective of stable prices.

Representative PATMAN. My time has expired. I will have to yield.

The CHAIRMAN. Congressman Bolling.

Representative BOLLING. Earlier in the discussion I think everybody pretty well agreed that the interest rates had, I do not know exactly the word used, a minor effect on savings. I gather that was generally minor.

Does an increase in the interest rates check capital spending and if so, what kind and by whom?

Mr. BUTLER. I would say that interest rates are again one of the factors that affect capital expenditure plans. I would think that the combination of interest rates plus tight money operates on the side of making business look more carefully at its capital expenditure plans.

I think there are projects which will not be approved in such a period that might go through under lower interest rates. Again I think it is the relationship between interest rates and the rate of return that can be earned that determines whether the investment will be made. Obviously the effect is much more important on heavy capital using projects such as utilities than it is on some manufacturing projects. But I think it does have an effect and it has an effect also on investment in inventories.

Representative BOLLING. Any other comments?

Mr. RATCHFORD. I would subscribe to what Mr. Butler has said.

In fact, the primary purpose for restrictive measures in the financial markets is mainly to restrict the use of capital. If it were not for that, I don't think there would be any valid excuse for tight money or restrictive measures by the Federal Reserve System.

If it does not acomplish that, then it does not accomplish its purpose.

Representative BOLLING. Any further comment?

Mr. GORDON. I think that it is not high interest rates in the abstract, but the level of interest rates with respect to what they have been in the past and what people think they are likely to be in the future.

Certain types of borrowing are affected more by high interest rates than others. We know that housing has been probably to some extent. Some States and local subdivisions have put off, if not abandoned at least postponed, bond flotations and expenditure programs.

In addition, a period in which interest rates are moving up and bond prices are falling creates a period of uncertain short-term expectations on the part of security buyers and may have an effect on the ability of corporations to float securities at a particular time and on the willingness of investment bankers and underwriters to take them at narrow margins at a particular time.

Mr. SAMUELSON. I agree with the other three panelists that a tightening of money, which means making money dear and hard to get, does have a substantial effect of a quite different order of magnitude on investment than it has upon savings.

By the same token, I think that the easing of money, making interest rates cheaper, and I would very much emphasize, and also easier to get, can have a substantial effect upon capital formation.

I would say that we economists were a little misled in the depths of the great depression by generalizing from that experience. It certainly was true when gold was flowing into this country, if anyone can remember such a time, and short-term rates were down to the floor, and when I say the floor I mean a third of a third of a third of 1 percent, and banks had excess reserves everywhere, that more orthodox bank expansion would not have had an effect upon investment.

From that we wrongly concluded that the monetary policy and interest rate policy had gone out with Queen Victoria and from now on the important thing would exclusively be fiscal and other policies.

Representative BOLLING. Is it possible to do any statistical demonstration of this in the last couple of ups and downs in the last 20 or 25 years to show a demonstrable substantial reduction in capital investment in the period of, say, tighter money and so on?

Mr. SAMUELSON. I would first say that the last test that you proposed is not a relevant test. The question is not the historical experience at the tops of booms when interest rates are high and at the same time capital formation is high; that throws no light on what the effect of interest rate and capital rationing would be as compared to a differential degree of it.

If I may say so we are trying to get at the elasticity of the demand curve for investment and capital and we cannot infer from shifts in that curve what the behavior on that curve would be.

I apologize for being so pedantic.

Representative BOLLING. I do not mind your being pedantic. I want you to give us light in this field.

Mr. SAMUELSON. I think one has to crucially examine all the experience including anecdotal. One finds that a number of States do postpone some capital formation because they expect interest rates to become lower later.

Sometimes, by the way, and Mr. Means should think about this, it turns out they only come into the money market later and pay a still higher rate than previously.

But what is against all this is the fact that internal funds of business corporations are very substantial and in connection with the survey data that Mr. Butler has been talking about, the McGraw-Hill survey shows, for example, that almost all the firms allege that they will be financing the greatest part of their fixed capital spending of the next year or so out of internal funds and will be somewhat insulated from the money market.

I will argue, but I do not want to argue here, that even here there are some subtle effects of the external market on internal decisions.

Representative BOLLING. Is it possible to do any quantification on this?

The suggestion is made that this has an effect upon residential construction—everybody seems to agree on that—that it might have had an effect on State and municipal and probably has some effect even on investment that is largely internally financed.

What is one roughly in relation to the other and so on, to the whole and so on?

What proportion of the investment do we find in residential housing and State, municipal, and financing, internal or otherwise, of large business enterprises?

Mr. SAMUELSON. According to the data of Simon Kuznets, who is the last word in these matters, the great components of capital formation in the past have been things like railroads, city and interurban streetcars, housing, public utilities, etc. These are not the types of activities that we think of as an ordinary manufacturing concern which, by plowing back earnings and keeping its dividend payout to one-third, is able largely to finance its own needs.

These people repeatedly have had to come to the market and the conditions of the money market, I think it is fair to say, have had impact upon their effective decisions.

Representative BOLLING. What I am trying to get at is: Is it possible in relation to recent years to see what the quantity of investment has been in this type of thing you are talking about, the private area where they do come into the money market and the area where they do not come into the money market but do it largely internally?

The obvious reason for my interest was to see the relative effectiveness of monetary policy in this gross field.

Mr. GORDON. I wish we could do what you suggest, Mr. Bolling, but I think it is literally impossible for a number of technical reasons. We can give you a breakdown of investment.

As a matter of fact, one of the tables in the Economic Report gives data on how much gross capital formation goes into manufacturing plant, equipment, residential building, commercial building, and so on. We cannot tell you, obviously, how much more, if any, there would have been of each of these types had interest rates been 1 or 2 or 3 percent lower than they actually were.

Further, there is a whole package of factors that is involved when we talk in shorthand about high interest rates or tight money. It is not merely the interest rate, but it is also what happens to the structure of interest rates. It is also what happens to the availability of funds, because the interest rate itself is not a complete index of whether different classes of borrowers can borrow when they need the money, and there is also the fact that associated with various degrees of ease or tightness in the money market is more or less liquidity on the part of consumers and business firms.

All of these things add up in a very complex package which economists, I believe, feel has some effect on spending, but we can't tell you how much.

Representative BOLLING. I would like to end by questioning with this: How would you relate this "some effect" to the minor effect that interest rates would have on savings?

What word would you use on this "some effect"?

It is, I take it, substantially more than money.

Mr. GORDON. If I may make a qualification for what I said about consumer debt and its effect on personal saving a little while ago, my own guess would be that the effect on the borrowing side is greater than the effect on savings out of income.

Representative BOLLING. Would there be general agreement on this?

Mr. RATCHFORD. Yes.

The CHAIRMAN. I would like to address a question on debt management.

It is the policy of the Treasury to issue its long-time securities with a given interest rate and at a fixed price of parity. There is, therefore, no competition between investors except on one thing, the amount which they are to purchase.

The historic record of these issues indicates that in every case I think, except possibly one, the issue has been oversubscribed, that generally there is a double subscription, in a few cases less than twice, in some cases as high an oversubscription as five or six times.

The majority recommended on these long-time issues that we should have an auction system rather than a fixed price system with the investors bidding against each other at given interest rates and the effect is that the market for Government securities be broadened so that the Treasury could deal as directly as possible with a wide range of those who want to use the savings sought.

As I say, we call it broadening the market and adopting the auction system rather than fixed price or parity system.

Dr. Ratchford, I wonder if you have any comments to make on that?

Dr. RATCHFORD. I would certainly be in favor of it, Mr. Chairman, if it were feasible.

I believe Secretary Anderson indicated also he would be glad to if they could solve the problem.

I am no technical expert certainly on matters of this sort, but from what I have heard and read, I am impressed by the difficulties, the practical difficulties of implementing it. If those could be overcome, I would certainly be in favor of it.

The CHAIRMAN. Dr. Gordon?

Mr. GORDON. I think that my reply would use exactly the same words that Mr. Ratchford does. I don't know very much about the technical problems that might arise, but if these are not insurmountable I would favor it.

The CHAIRMAN. Mr. Butler.

Mr. BUTLER. I would agree.

The CHAIRMAN. You would agree?

Mr. BUTLER. I would agree, yes.

The CHAIRMAN. I regard this as very real reinforcement.

Mr. SAMUELSON. May I——

The CHAIRMAN. Yes, you take your turn, Mr. Samuelson.

Mr. SAMUELSON. I would generally agree with what has been said here, including the disclaimer that I have not gone into the technical features of the matter.

I would add that I do not regard this as a very important matter.

I would also add that the effective test as to whether the Treasury is paying too much is not provided by the degree of oversubscription. People have learned that they must oversubscribe in many cases in order to get their quota.

The CHAIRMAN. Just a minute, Mr. Samuelson.

Is that not derivative of the fact that they know that this will be an oversubscription?

Granted that this exaggerates the amount of the oversubscription, does it not indicate that basically at the interest rate charged, at the

interest rate offered, and at the fixed price, the quantity of bonds demanded exceeds the quantity of bonds supplied?

Mr. SAMUELSON. There is certainly that element.

However, once that belief is established, it would create a vicious circle in which people would continue to oversubscribe, which would prove nothing.

I would propose a sharper test, on which occasions and to what degree did the new Government bond on the open market immediately go to the premium, what was the size of that premium, and on what occasions did they immediately go to a discount or very soon go to a discount?

If we examined the record there, all Secretaries of the Treasury in the past, and I include the Democratic ones, have had a certain vanity in which they like to have the thing go over the top and therefore they make the terms a little bit juicer.

On the other hand, you will recall the 1953 experience, the Humpty Dumpties, you will recall the experience of last June——

The CHAIRMAN. Just a minute on the 1953.

How do you interpret that 1953 experience?

Mr. SAMUELSON. I recall a 3¼-percent bond was offered. That sounded high to people for a bond of that duration at the time. Every ribbon clerk began to get on the bandwagon. He thought he was going to get a free ride.

For certain extraneous reasons, the thing was handled very badly from the technical end, and a Confederate holiday happened to intervene so that no allotments were made for many days, and ribbon clerks began to sweat, as they had an obligation the size of which they didn't know.

Subsequently, far from the Treasury having issued those at too juicy a price, the people took a very bad beating.

The CHAIRMAN. Yes, but at what time? The immediate effect was premium, was it not?

Mr. SAMUELSON. Well, a very short-lived one.

The CHAIRMAN. I believe it went up 10 to 15 percent.

Mr. SAMUELSON. My recollection is that there was a very small time when a very nimble person might have gotten out with his shirt and something better, but that was an extremely short period because the money market, as you recall, was in a state of collapse during those months.

The CHAIRMAN. I think this is a matter which we should have a record of.

I am going to ask the staff to review a record of these issues as to what happened immediately, what they were quoted after a few months, what after a year.

The subsequent fall in the 3¼, of course, was primarily due to the rise in interest rate which made even the 3¼ percent rate obsolete.

Mr. SAMUELSON. Have your staff also look into the June 1958 case.

Now, I believe that an auction system known in advance to take place would probably scare off some free riders. They would realize, just in case this happened to be a tremendous genuine demand, they would not be able to capture the full consumer surplus of that subsequent rise, because the auction market would automatically capture that for the Government.

The CHAIRMAN. Would you say it would eliminate some of the speculators?

Mr. SAMUELSON. Some, but I would add this is not a really terribly important matter.

The CHAIRMAN. Another recommendation that our committee made was that there should be at least customer margins on the purchase of Government bonds.

I must admit that when the debacle in the price of Government bonds came in the summer of 1958, I was startled to find that the margins requirements were very low; in some cases none existed.

We held some special hearings last summer in New York on this matter. It develops that only 5 of the 17 firms are members of the New York Stock Exchange and, therefore, the other 12 are not subject to the rules of that organization, that in practice the margin requirements for longtime securities are something like 1 percent and on short time virtually none existed; none at all.

Does this not promote excessive speculative swings in the prices of Government securities as was evidenced in 1958 when there was a big rush to purchase these longtimes and then when their price fell a liquidation, a forced liquidation, cumulated liquidation, which brought the price of Governments way down and damaged the credit of the United States, at least so far as the foreign countries were concerned.

So one of our recommendations is that the Federal Reserve should have the same power to impose margin requirements on the purchase of Government bonds as it has in the case of stock.

Of course, the margin should not be as great. What do you think of that general proposition, Dr. Gordon?

Mr. GORDON. I would be in favor of it. Like Mr. Samuelson, I am not sure that this area is the one I would put high on the list of the important issues about which it is important to make decisions.

You must remember that there is a long background behind the experience that we have had in the last couple of years here. There was a period of almost 20 years in which we had artificially low interest rates. Prospective buyers of Government bonds simply came to expect that every issue would soon go to a premium, and over that generation a habit of speculating in Government bonds for a quick turnover on virtually no margin gradually grew up.

I thing it is just as well that those people were taught a lesson, as they were particularly, as I recall, in the two and five-eights.

I think we would be better off if this sort of thing did not go on.

The CHAIRMAN. Do you favor margins then?

Mr. GORDON. Yes, I would have no objection to that. I see no reason why people who should not be speculating in Government bonds anyway should be encouraged to do so by the existence of lower or no margin requirements.

Mr. BUTLER. I think some special arrangements would have to be made for the dealers in Government securities. If you are going to have a market you have to have dealers and the dealers do not have the capital or could not profitably raise and use the capital that would be required if they had to pay higher margins.

The CHAIRMAN. I want to make it clear that I think a distinction should be drawn between the traders and the customers so to speak.

Mr. GORDON. That is right.

With that footnote I would agree that margins would be reasonable.

Mr. BUTLER. I agree that margins would be helpful but again I don't think they are a matter of major concern. We have had one experience in which this has been important. I don't think this is likely to occur often.

Mr. RATCHFORD. If we had abandoned the "bills only" policy and did have the Federal Reserve operating across the board, it would presumably produce more frequent movements in bond prices and would therefore be a stimulus to more speculation in bonds than is true at present.

The CHAIRMAN. Did I ask your opinion, Mr. Samuelson?

Mr. SAMUELSON. I have not expressed an opinion. I am not enthusiastic about margin requirements. The main argument for them, I would say, is that there are perhaps some little fellows who are doing damage to themselves and since the U.S. Government operates in a paternalistic manner with respect to quite a number of things, based perhaps upon the inherent attitude of the man in the street toward what he regards as gambling, I see no reason why Government bonds should be a sacrosanct area here.

The CHAIRMAN. In other words, it should not go along with the numbers game and other forms of roulette?

Mr. SAMUELSON. If you have margin requirements that should be your principal motivation, not the belief that you will be stabilizing the market.

Now, my interpretation of the June 1958 experience is quite other than that speculation was the important thing about it at all. It came at a turn in the business cycle when I think some of the inside people recognized the turn had come, but most people had not.

You will note that it was not a question of the market plunging in a disorderly fashion and then later recovering and going to a premium.

On the contrary, those bonds have been a headache to anyone who has held them over since that date.

The CHAIRMAN. I grant what you say, but I think it is also true from the testimony which we took in New York, that there was distress selling and the fall in price of governments caused by the change in business conditions, with nonexisting margins, required purchasers to put up money which they did not have and therefore led to distressed selling.

Certainly it is not true that the low margins on stocks in 1929 were the initiating cause of the stock market debacle. But once the debacle started, it led to distress selling, which caused the fall to be intensified.

Mr. SAMUELSON. Yes, by the way, let me say in connection with stock market margins, without regard to one's attitude toward gambling. I am delighted for the stability of the system that we don't have 10 percent margins and 5 percent margins such as prevailed in the 1920's.

We happen to have 90 percent; that may be high at the moment, but it does keep retreats more orderly.

The CHAIRMAN. I think we have exhausted the stamina of these witnesses. We appreciate their coming very much.

I think perhaps I should announce that Secretary Anderson will be here next Friday, February 12, at 10 a.m. I also wish to acknowl-

edge the presence of a number of junior staff members of the International Monetary Fund who have been here observing the hearings this morning.

We appreciate their coming. We want to thank you for taking part.

The CHAIRMAN. The Chair would also like to ask unanimous consent that the staff insert in the record in connection with the discussion on whether lowering reserve ratios or open market operations should be the means to expand the money supply in a secular fashion the appropriate statistics on the earnings of banks be printed in the record, together with a definition of what the rate is computed upon, whether merely capital or whether capital and surplus.

Without objection, that will be done.

Earnings and earnings ratios of all member banks

[Dollars in millions]

Item	1955	1956	1957	1958	1959, 1st half
Net current earnings before income taxes	$2,077.5	$2,398.3	$2,548.6	$2,509.7	$1,386.4
Profits before income taxes	1,676.0	1,744.3	2,063.5	2,606.0	1,007.9
Net profits	985.2	1,026.6	1,169.0	1,457.2	597.3
Cash dividends declared	501.0	547.0	603.8	646.2	325.3
Total capital accounts [1]	12,499.0	13,270.0	14,108.0	15,086.0	15,668.0
Percentage of total capital accounts:					
Net current earnings before income taxes	16.6	18.1	18.1	16.6	17.7
Profits before income taxes	13.4	13.1	14.6	17.3	12.9
Net profits	7.9	7.7	8.3	9.7	7.6
Cash dividends declared	4.0	4.1	4.3	4.3	4.2

[1] The figures for capital accounts include book value capital stock, surplus paid in or earned, and undistributed profits representing averages of the amounts reported for the call date at the beginning, middle and end of each year plus the last-Wednesday-of-the-month figures for the 10 intervening months.

Source: Federal Reserve Bulletins, June and October 1959.

The CHAIRMAN. Thank you, gentlemen.

(Thereupon, at 12:50 p.m., the committee was recessed, to reconvene at 10 a.m., Friday, February 12, 1960).

JANUARY 1960 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, FEBRUARY 16, 1960

U.S. CONGRESS,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a. m., in room G–308, New Senate Office Building, Hon. Paul H. Douglas (chairman of the committee) presiding.

Present: Senators Douglas, Sparkman, Bush, and Javits; Representatives Patman, Coffin, Curtis, and Widnall.

The CHAIRMAN. The committee will come to order.

Mr. Secretary, we are very glad indeed to welcome you. We hope that the sunshine and salubrious climate of San Salvador has restored you to health. We appreciate very much your courtesy in coming up to testify. I think I should like to begin with a statement, and then with a question.

Most Government securities, other than bills, are now sold at a fixed price, namely, par, at a fixed interest rate, and at a fixed maturity. Bidding is limited to the volume of such securities which the buyers desire to purchase. These issues are ordinarily greatly oversubscribed. It seems to me that there is not any feature of this system which can properly be called competitive.

Now, the question is this. Suppose, Mr. Anderson, that a dear uncle of yours, Uncle Samuel, puts you in charge of his store, and one of the attractions of this store is the sausage counter, where periodically you sell sausages of very fine quality. Now, you adopt the policy that the sausages must always be sold for a dollar a pound. Just a dollar a pound. No one can pay more. No one can pay less. This is the policy which you follow month after month, year after year. Each time when these sausages come upon the market, the number of people there who want to purchase the sausages and the number of sausages which they want to purchase are much greater than the number of sausages which are available. But you do not raise the price nor do you diminish the attractiveness of the sausage. So you have to ration these sausages among your purchasers.

Generally there are twice as many sausages demanded as supplied. Sometimes five or six times as many sausages are demanded. Now, don't you think this is a highly irrational, and you will forgive me, Mr. Secretary, if I say so, highly irresponsible method of selling sausages? Wouldn't you think it was a highly irresponsible way of selling sausages?

Representative CURTIS. Mr. Chairman, point of order, please. I think the Secretary has a statement to make.

The CHAIRMAN. I beg your pardon. I was so anxious to get into this that I forgot about the statement. The Congressman is completely correct, and I beg pardon of the Secretary. Excuse me, Mr. Secretary. I am sorry. You should make your statement before I ask a question.

STATEMENT OF HON. ROBERT B. ANDERSON, SECRETARY OF THE TREASURY

Secretary ANDERSON. Mr. Chairman, in the first place, I should like to express my apologies to the committee for not being able to appear when I was scheduled before, and I thank the chairman particularly and the committee for your courtesy in excusing me at that time, and allowing me to appear now.

Experience in the 1950's demonstrated the immense resiliency, strength, and adaptability of our free enterprise economy. As we enter the decade of the 1960's, the economic outlook is indeed encouraging. But we should not permit a favorable outlook to lull us into unwarranted complacency. The challenge that confronts us—not solely in Government, but every individual, group, and institution in this country as well—is to conduct our affairs in such manner as to prolong the prosperity that we are now enjoying.

Our budget projection of the economy for 1960 reflects this favorable outlook. It is always difficult, of course, to make specific assumptions covering a budget which extends over the next 18 months. Our best judgment is, however, that a gross national product of $510 billion can be reasonably projected for the calendar year 1960, compared with a $479 billion total for the calendar year 1959. Our projection of personal income for this calendar year is $402 billion, as compared with $380 billion in 1959. Our projection of corporate profits of $51 billion in this year compares with a $48 billion figure for the calendar year which has just been completed. All of these estimates are stated in terms of present price levels. We believe these estimates represent a realistic appraisal of the current outlook and fully support our projection of $84 billion of Federal Government revenue for the fiscal year 1961.

We must make certain that the growth we experience this year—and in the decade as a whole—is growth at a sustainable pace, unwarped by the distortions, imbalances, and excesses that, if allowed to emerge, inevitably sow the seeds of reaction and recession. This need for balanced growth emphasizes the necessity for combating any incipient buildup of inflationary pressures.

Inflation—either in the form of a gradual, insidious rise in the price level, or as a rapid increase in costs and prices—is in fact the enemy of sustainable growth. Inflation breeds the very recessions and unemployment that stand as a barrier to sustained growth. And either the fear or the fact of inflation, by impairing the will to save in traditional, fixed dollar forms, will in the long run lead to a shortage of savings to finance the real investment in plant and equipment that is so essential to the growth process.

The fact that inflation, if allowed to occur, can be expected to stunt our rate of growth in the future provides sufficient reason for determined efforts to prevent further erosion in the purchasing power of the

dollar. We must also be continuously mindful of the impact of inflation on various groups in the economy, particularly those people whose incomes are relatively fixed, who live on the proceeds of pensions, annuities, social security, and similar types of savings.

Beyond these considerations is the important fact that further inflation can only impede our efforts to reduce the deficit in our international balance of payments—a deficit which threatens to hamper our efforts to contribute as we should to the military security and economic strength of the free world. Our attack on this problem will continue to be consistent with our vital goal of promoting multilateral world trade. It will, in short, be directed—not toward protectionism and restriction—but toward liberalization and expansion of world commerce. We shall continue to search out appropriate ways of encouraging American exports of goods and services; to press for removal of discriminatory restrictions on dollar imports abroad; and to encourage other industrial countries to participate more adequately in the provision of capital to underdeveloped countries.

It would be an empty achievement, indeed, if we were apparently successful in these efforts, only to find that internal inflation in this country had impaired our competitiveness in foreign markets. Thus, international developments provide still another important reason for maintaining stability in the price level as we pursue our goals relating to growth and employment.

Inflation was held largely in check in 1959. Although consumer prices—reflecting a continued uptrend in prices of all major groups except food—rose by a small amount during the year, the wholesale price index actually declined slightly. While this performance was good, and is a cause for satisfaction, it is no cause for relaxation of our efforts to protect the purchasing power of the dollar.

In an economy so large and highly diversified, the causes of inflation are bound to be complex, and it follows that there is no single, simple cure. We know, for example, that inflationary pressures are fostered by waste and inefficiency, whether these occur with respect to business management, labor practices, individual actions, or the activities of government. A rise in certain types of costs of production faster than increases in productivity can also contribute to inflationary pressures. In addition, undue concentration of market power may permit certain industries to raise prices in the face of declining demands, and shifts of demand from one type of goods and services to another may also exert a net inflationary impact. The nature of some of these forces is not yet fully understood; further study and evaluation are necessary before policies to deal with them can be formulated.

But of one thing we can be certain; the overall relationship between the demand for and supply of total output is still basic to any meaningful attempt at inflation control. Consequently, unless we are especially diligent in our efforts to prevent an unsustainable upsurge in economic activity during a period of expansion, we almost surely must resign ourselves to the price increases that result from such excesses. Moreover, as pointed out earlier, unsustainable upsurges tend to be followed by corrective recessions and consequent unemployment of labor and other resources.

Federal financial policies—including Government actions with respect to the budget, monetary management, and public debt operations—are generally recognized as having a significant impact on total demand for goods and services in the economy. As a result, the constructive use of these policies must stand in the forefront of our efforts to fight inflation, as well as our efforts to combat recessionary tendencies. We must recognize that, while such policies alone cannot assure success in our efforts to attain sustainable economic growth, their utilization in a prudent and responsible manner is essential.

Opinions differ as to how these three policies should be used, and this is especially true with respect to budget policy. According to one view, a period of actual or threatening inflation, reflecting at least in part the pressures of demand, would call for a large surplus in the Federal budget. This would be achieved by an increase in tax rates, a cut in expenditures, or some combination of the two. Such a surplus, it is argued, would help dampen total demand inasmuch as Federal Government spending would fall short of revenues.

This program would, according to this view, be consciously and actively reversed during a recession. Reductions in tax rates and increases in expenditures would contribute to a large deficit in the budget; such a deficit would stimulate total demand, inasmuch as Government spending would exceed revenues.

This approach has some serious shortcomings in practice. For one thing, decisions as to taxes and spending programs often reflect many factors other than broad economic considerations. Moreover, the timely use of budget policy as a conscious countercyclical weapon is hampered by the fact that authority over taxation and spending is the joint responsibility of the Executive and the Congress, and is not centered in one branch of the Government.

In addition, experience since the end of the Second World War indicates that it is much easier to achieve a budget deficit in a recession than a surplus in a period of economic expansion. Sizable deficits in recessions—only partially offset by modest surpluses in periods of expansion—tend to complicate the task of achieving sustainable growth in at least two ways. The net deficit over a period of years probably adds to inflationary pressures and secondly, the growth in the public debt that is implied by such deficits, along with the difficulties encountered in managing a growing debt, is likely to complicate the flexible and timely administration of monetary policy.

Moreover, recent experience supports the view that conscious and active attempts to vary tax rates and spending to help avoid inflation and combat recession may well have perverse effects. Changes in tax rates and spending may sometimes take so long to plan, legislate, and put into effect that many months may pass from the time the need for a change in budget position becomes clear until the change actually affects total spending in the economy. By the time the actions become effective, the economy may have changed radically. As a consequence, large deficits may have their major impact during periods of rising business activity; surpluses may in fact be encountered during a business slump. Any proposals for an arrangement that would permit some sort of administrative variation in tax rates to counter cyclical trends, such as vesting additional authority in the executive branch,

do not seem to be consistent with the system of checks and balances that is so important in our form of government.

Are we thus left only with the alternative of striving for a rigorous balance in the budget, year in and year out? I do not think that we are. The goal of a net surplus in the budget—not only in prosperous periods, but, on the average, over a longer period of time also—is highly desirable. Furthermore, budget deficits of moderate size are probably unavoidable—and indeed, desirable—during periods of economic recession.

We should, in my opinion, follow some variation of the stabilizing budget proposal, in which budget policy, year in and year out, would be geared to the attainment of a surplus under conditions of strong economic activity and relatively complete use of labor and other resources. On this basis, the automatic decline in revenues and increase in expenditures during a recession—reflecting in part the operation of the so-called built-in stabilizers—would generate a moderate budget deficit. In prosperous periods, tax receipts would automatically rise and certain types of spending would contract, producing a budget surplus.

Over a period of a complete business cycle, a surplus for debt retirement would be achieved, but without the disrupting effects of necessarily attempting to balance the budget in recession. While intentional variations in tax rates and spending for cyclical purposes would thus be kept to a minimum, conditions might well arise in which such variations would be desirable.

The budget submitted by the President for fiscal year 1961 is fully consistent with this approach; about 5 percent of Federal revenues are earmarked as a surplus for debt retirement. If economic conditions were to change drastically and recession were to set in—a contingency which does not seem likely but is of course possible—the surplus would automatically be converted into a moderate deficit as tax revenues decreased and certain types of expenditures rose.

With the economy operating at high and rising levels of activity, the achievement of a $4.2 billion surplus in the Federal budget will help reduce the burden on monetary policy and will also facilitate debt management. In my judgment the lack of adequate surpluses in the prosperous years following the Second World War—which has resulted in a more than $30 billion increase in the public debt since the end of 1946—has meant that monetary policy has been called upon to bear more than its proper share of the burden in promoting sustainable economic growth. This unavoidable heavy reliance on monetary policy may have contributed to wider swings in interest rates and capital values than would have been necessary if budgetary surpluses had been adequate. But it seems incorrect to argue that monetary policy has tried to assume too large a role; the conclusion is rather that the degree of monetary restraint has had to be greater than would have been the case if budgetary surpluses had been adequate.

To some observers, Treasury debt management—the third Federal financial policy—affords a highly useful technique for promoting sustainable economic growth. Although the Treasury attempts to manage the public debt in a manner consistent with the attainment of our basic economic goals and, insofar as possible, tries actively to promote these objectives, the vigorous use of debt management in this fashion is sometimes impeded by important practical considerations.

Inasmuch as these difficulties have been described in detail in the material supplied by the Treasury to this committee in connection with its recently completed study of employment, growth, and price levels, I shall not discuss them at this time.

During a period of strong business activity, however, the Treasury should at least possess sufficient flexibility in debt management to be able to avoid debt operations that actively promote inflationary pressures. Otherwise, the beneficial effects of prudent budget and monetary policies may in part be offset. In particular, reliance on inflationary short-term financing should be minimized, and a reasonable amount of long-term securities should be marketed, either through cash issues or in advance refunding of outstanding securities.

Under today's market conditions, however, the 4¼-percent interest rate ceiling on new issues of Treasury bonds effectively prevents the Treasury from issuing any significant amount of new marketable securities of more than 5 years' maturity, either for cash or in exchange for securities at maturity or in advance of maturity. The Treasury is thus prevented from achieving any meaningful amount of debt lengthening—or even of holding the average maturity of the debt close to its present length of only 4 years and 3 months. The interest rate ceiling is therefore forcing the Treasury to pursue inflationary debt management policies.

To the extent the Treasury concentrates its new issues in the 4- to 5-year maturity range, the decrease in the average maturity of the debt can be slowed, but there is a limit to the amount of securities of this maturity that can be sold without driving interest rates in this sector of the market to very high levels. Moreover, experience has indicated that undue concentration of new cash issues in the 4- to 5-year range, at the rates the Treasury would have to pay, might have a strong impact on the capital market—and particularly the mortgage market—as individuals withdraw funds from savings institutions to purchase the Treasury issues.

The restriction on interest rates that the Treasury can pay on new marketable bonds is in effect preventing the effective and proper use of Federal financial policies to promote sustainable economic growth. It would be regrettable indeed if the salutary effects of prudent budget and monetary policies were permitted to be offset in part by so artificial a restriction. The President has once again urged removal of this harmful restriction, and it is to be hoped that early action in this respect will be taken, so that debt management can also bear its proper share of the burden in our efforts to achieve our vital economic goals.

The CHAIRMAN. Mr. Secretary, may I apologize again for beating the gun with this question.

Secretary ANDERSON. It is perfectly all right.

The CHAIRMAN. Perhaps the delay may have an incidental aid in helping your staff to think up an adequate answer.

Let me first say that I would like to emphasize degrees of agreement. I am pleased that you declare that there has been an insufficient use of fiscal policy during the last period, and that this has thrown a greater burden upon monetary policy. I think this was the major conclusion of the report of our Joint Economic Committee, and while you do not accept this in toto, you give it a qualified acceptance,

and I am very happy to see that. So we may be beginning to come together.

Now, you have noticed, of course, the fall in the interest rates during the last 6 weeks, have you not?

Secretary ANDERSON. Yes, sir.

The CHAIRMAN. If my information is correct, on the 9th of January the average yield on 91 day Treasury bills was 4.062 percent. As of February, this fell to 3.562 percent, or a decrease of roughly 1.1 percent, or relative fall of 22 percent. This a great decrease in a short-time rate. The short-time rate is of course more volatile than the long-time rate. But as of the 13th of February, the long-time rate had fallen from 4.37 to 4.20. So in this last 5 or 6 weeks there has been a downward movement in the interest rates.

One reluctance which many of us have in this matter is our belief that interest rates which have been rising steadily over these last years are now due to go down, and the long-time rate is familiar to you. If we give you the right to refund at more than 4¼ percent, and you have not issued callable bonds, you issue these bonds at high rates of interest for 20 years, then the interest rate falls, and we are left stranded, so to speak, with a high interest rate, and therefore high payments by the taxpayers, which do not correspond to reality.

With this development in the last 6 weeks, which is not shown on the charts there, we wonder if this is not really a very powerful reason why you should not seek this increase in ceiling? As a matter of fact, the long-time yield is even now below the ceiling and the extraordinary situation which we had for a time of the short time being above the long-time rate has now disappeared.

I wonder if this is a wise policy for you to adopt at the present time?

Secretary ANDERSON. Senator Douglas, it would seem to me that the policy of waiting to see what happens would be in error, unless we are willing to assume that we are entering a period of substantial economic recession. A substantial portion of the recent decline in the rates, in the judgment of knowledgeable people, I think, has resulted from seasonable factors which are normally apparent in every January and February. Part of it may reflect the prospect of a very much reduced amount of Treasury cash borrowings in the next year or so, in view of the improvement in the budgetary position. Part of it may be a reflection of the growing judgment that 1960, instead of being a year of strong inflationary pressures, which affect interest rates more acutely than most other factors, would be a more normal year of healthy growth. With regard to the rates which have declined substantially in the short-term area in recent weeks, you may have noticed that yesterday the bill rate on the 91-day bills at auction moved up from 3.56 to 4.045. The 26-week bill rate moved from 4.094 to 4.294 in 1 week. In addition, there has become an awareness on the part of investors of the spread between earnings on stocks and bonds. The current level of long-term rates, which actually have gone down very little, would not give the Treasury any opportunity to do more than a handful of advance refunding of Government securities at 4¼ percent, if we have any leeway at all. While it is true that a few of the long-term issues are selling in the market at less than 4¼ percent, these yields do not indicate the rates which the Treasury would have to pay on the next issue. We would have to pay more to make them attractive.

This is important in part because of tax considerations. In buying the existing bonds selling at a discount, the buyer can take capital gains, whereas in buying bonds which would be issued by the Treasury there is treatment of earnings as capital gains only when the discount does not exceed a quarter of 1 percent per annum for the life of the outstanding issue.

The CHAIRMAN. Mr. Secretary, have you finished?

Secretary ANDERSON. Yes.

The CHAIRMAN. Mr. Secretary, even if you take into account the rising yields as of yesterday, it is still true that the yield on short terms is over half a percent below what it was 6 weeks ago. On January 9, it was 4.602 percent, and as of yesterday you said it was 4.045, so that is a decline of half a percent or a decline of one-eighth during this period. Close to one-eighth, I would say. What was the long-time yield yesterday on taxable bonds? My figure for February 13 is 4.20.

Secretary ANDERSON. I do not have the average worked out. We have a complete list of quotations we could supply for the record.

The CHAIRMAN. That is a decrease of 0.22 of a percent from January 9, which is quite a fall. You say this is purely a seasonal decrease. I am not at all certain it is a seasonal decrease. I think what is happening, you gave one of the clues to this, is that the craze for stocks has subsided somewhat because it is realized that the price of stocks is higher than the yields justify, and that therefore the rate of return on stocks is certainly less than the rate of return on bonds.

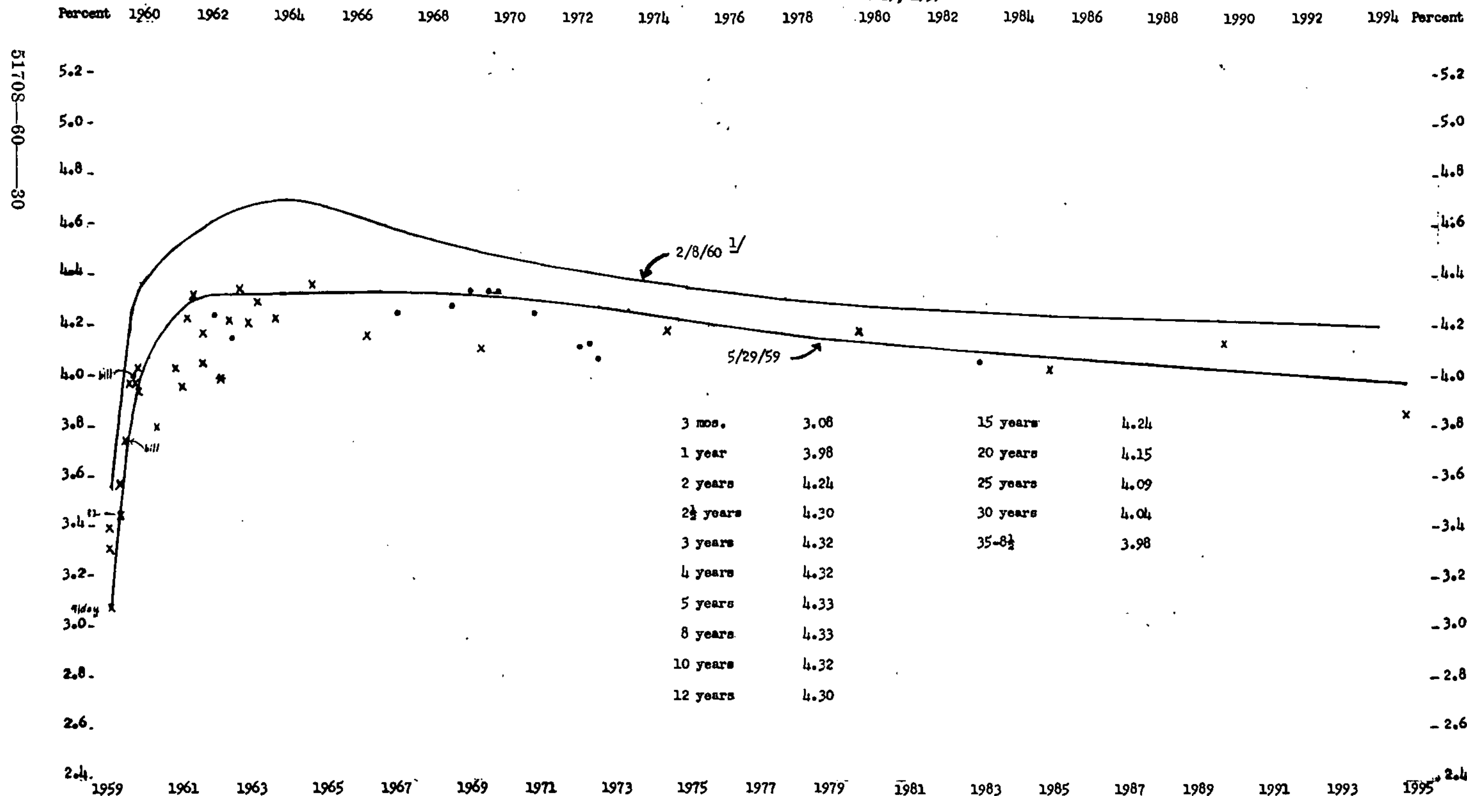
Secretary ANDERSON. Yes. I do not want to leave—excuse me.

The CHAIRMAN. If we are going to have a movement of investment capital out of stocks into bonds, this is going to raise the price of bonds and decrease their yields. I would think that you may praise us in the future for not having given you that authority of floating 5 percent bonds next summer. Future generations may rise up and call us blessed.

Secretary ANDERSON. Senator, I do not want to leave any impression that I think this is purely seasonal. I think that is one of the factors. As I tried to emphasize, I think it is partially a disenchantment with stocks. It is partially a realization of the difference in yields. It is partially the fact that investors are thinking the Federal Government is going to be a contributor rather than a taker of money under a budget surplus. It is a subsiding of what were largely inflationary fears and a growing belief that we are going to be successful in having healthy normal growth. I think for the Senator's benefit, you might like to see a chart which we have here, and which I will leave with you, indicating the total movement of long- and short-term rates over the past 18 months.

The CHAIRMAN. We are very glad to receive that.

(The chart referred to faces this page.)



1/ Shifted to reflect some time to maturity as for 5/29/59

51708—60——30

The CHAIRMAN. If I may return to this hypothetical question about the method of floating long-term bonds which have a fixed interest rate, a fixed price, namely, par, and a fixed maturity, and which are always oversubscribed from two to five or six times, although sometimes it has been less than two, and the homely analogy I used of sausages, suppose you have a greater quantity of sausages demanded at a given price than are supplied at that price, doesn't this indicate that in a competitive market you could get a higher price for the sausages?

Secretary ANDERSON. Senator, the use of——

The CHAIRMAN. Wouldn't your Uncle Sam, if you were running the sausage counter, say to you, "Nephew, don't you think you better increase the price of sausages, or if you want to keep them at a dollar, make them not as rich"?

Senator BUSH. Will the Senator yield for a question?

The CHAIRMAN. The Senator from Connecticut will have time enough on his own time.

Senator BUSH. I just want to make an inquiry about the Senator's question, as to whether in speaking of sausages he had any particular kind of sausage in mind, such as baloney?

The CHAIRMAN. I think the Treasury has been selling some baloney sausage. I think they have a good deal of baloney. I was too polite to call to the attention of the Secretary of the Treasury that fact, and I thought that the Senator from Connecticut would not put his colleague in so embarrassing a position.

Senator BUSH. No, it was the Senator's question that prompted my observation.

The CHAIRMAN. I think there has been a lot of baloney.

Secretary ANDERSON. Senator, being a farm boy, I appreciate the analogy of sausages. I would say in the first place, and I mean this in a most respectful way, the sale of the normally understood commodity and the sale of U.S. Government marketable securities, is in my judgment the sale of two very different sorts of things. One is very well understood.

The CHAIRMAN. Which one? Sausages or bonds?

Secretary ANDERSON. The normal commodities. The other I am not so sure of the degree to which it would be understood. It is my judgment that if long-term Government securities were offered entirely at auction that the initial market for the long-term securities would be significantly narrowed inasmuch as the inexperienced investor would be very reluctant to risk his funds and consequently the cost to the Treasury would be higher.

In the second place, the Treasury is very anxious to get its securities into the hands of true savers. By the pure auction technique as followed, we would lose control over the allocation of the securities and it very well might result in a larger portion being taken by the banking system and by speculators, and by a smaller number being taken by true investors who do not know precisely how to bid.

There is another very important factor, and that is the serious potential tax complications that would result from auctioning securities other than bills. The statute now provides that any discount that is in excess of a quarter of 1 percent per annum over the life of the bonds is ordinary income. Not only to the extent of the one-quarter,

but if it exceeds this, it is all ordinary income. If all of these long-term securities were bid at different prices, and put into the market on different bases, then the subsequent holders of those securities who might buy them from the original subscriber would be put to a very difficult position, as well as we in both the Revenue Service and the Treasury, in determining how they ought to be treated for tax purposes, because they would all be in the market, not with one price tag, but with a variation of price tags, depending upon the tax characteristics that might have applied to the bond.

Now, I think it is fair to say that in the past 18 months we have done more in the field of auctioning than has been done in the Treasury in 25 years.

The CHAIRMAN. Under a great deal of prompting from this committee.

Secretary ANDERSON. We have nevertheless done it, sir. We have issued not only the 91-day bills, but we have established a new cycle of 6-month bills and a new cycle of 1-year bills. The 6-month bills have been quite warmly received by the market, and are providing an important function as a new type of money market investment.

The 1-year bills have been successful, also, but I think in fairness I must state that there are indications that the actual cost to the Treasury resulting from the 1-year auction has been higher than if the Treasury had isued a fixed coupon instead.

I should like to point out the amount of Treasury bills outstanding at the present time exceeds $41 billion, or nearly twice the amount outstanding 5 years ago. All of these were sold at auction. In the 1-year area since January 1, 1959, the Treasury has on five occasions offered bills at auction in its new cycle. The average rate of discounts on those bills was 4.38 percent. In comparison, rates on outstanding issues of comparable maturity that were already available in the market averaged 4.22 percent. This means that we had a spread of 16 basis points between what one could actually buy in the market, and what was bid to get these new bills. However, the 4.38 average rate of discount does not reflect either the true yield to the investor nor the true cost to the Treasury, because as the Senator knows, Treasury bills are considered on the basis of bank discount and they are also based upon a 360-day year rather than the actual number of days in the year.

Now, when those two factors are considered, the true yield of the average issue was 4.60, not 4.38, and the average spread between the outstanding market and the auction on these bills amounted to 38 basis points.

Now then, let us take the converse. Since January 1959 we have issued six issues of certificates and short-term notes of approximately 1-year term. The average interest rate paid on the coupon of these issues was 4.27. The approximate yield available in the market at the same time for comparable issues was 4.08. The spread therefore was 19 basis points, or was exactly half of the spread between the comparable bills offered at auction and the 1-year certificates offered with coupons.

In the next place, the average size of the five bill offerings in which the public participated was $1.9 billion. The average amount of the certificates and notes taken by the public was $3.1 billion. Logically

one would expect that the larger issues would also require more of a spread between the new issue and the outstanding market to make it attractive.

On the other hand, all but one of the certificates and note issues were refundings and all but one of the issues of the bills were for cash. Refundings tend to have a lesser spread than cash offerings, so that perhaps neutralizes the "size of issue" factor.

There is another factor, namely that in all but one of the bill auctions, the Treasury offered the banks the privilege of subscribing for the new issues in tax and loan accounts, which means that the subscribing commercial bank could, if it wished, buy $5, $6, or more of the new issue for every dollar that it held in excess reserves. While there is always doubt as to how much the benefit will be because of the uncertainty as to length of time that the money will remain in the tax and loan account, it is an added benefit which would encourage the banks to bid aggressively and would thus increase the margin of yield between what one could go in the market and buy a comparable security for, and what the U.S. Government was paying for that issue at auction.

Senator Douglas, we are perfectly willing, and plan to continue to experiment and to utilize and to try to develop and enlarge auction. It would certainly simplify some of the responsibilities which weigh very heavily on me if auctions could be used more extensively. But I think we can only conclude that, under the conditions that existed during the past year or so, the Treasury might have saved one-fourth of 1 percent on its 1-year bills by selling them as fixed certificates rather than selling them at auction. I think it is something that we have got to proceed carefully with in the development of the market, taking into consideration all of these things which I have indicated.

The CHAIRMAN. You have made a very detailed statement which needs a great deal of careful analysis before one can reply to it, because it involves a statistical study. I simply submit that as a matter of commonsense that if at a given price a larger quantity is demanded than is supplied, this is an indication that under a competitive price system you could get a larger price or a higher price. I mean this is just a fundamental law of the market. Where you don't allow the buyers to bid against each other in terms of price, then you are driven into some form of rationing system. This is the system used in collectivistic economies, that is, the rationing system, which I am sure the Treasury does not wish to embrace as a general principle.

What some of us are saying is: Why not submit this to bidding? You don't have to follow under the auction system the idea of differing prices which you use for bills. You would not have to have each person buying at the price they set, as you well know. Furthermore, we have never maintained that you should do this with the present marketing mechanism for Government bonds. On the contrary, we have maintained that you should strengthen your own staff, and that you should seek to make direct contact with the savings institutions dealing broadly with mutual banks, building and loan associations, and other groups, instead of having some favored set of channels through which these bonds go to the general public. In short, we are urging that everyone have a chance to invest directly and to bid. I think if that happens there will be enough skilled financial advice available.

Secretary ANDERSON. Senator Douglas, if I may make one or two observations, the competence of people to bid—the kind of skill and knowledge that it takes—is a very difficult art. I think if you point out that for many, many years now we have had a public auction every Monday morning of the rollover of certain Treasury bills, one would assume in that long period of time that many mine investors, having become aware of such auctions, would come in and bid competitively. But out of the 4,000 or so bids that we have on the normal auction on Monday afternoon, only a few hundred of them are competitive bids and the rest of the investors simply put in their bids and say "Give me the bills at the average price," because they do not have the same competence.

Now, we have, of course, considered what happens in the sale of municipal securities at auction. In the case of municipals, normally there is a bidding arrangement in which different syndicates offer bids for the securities to be issued. But this is on the basis that the syndicate gets all of the issue or gets none of the issue. If one looks at the experience of the past year, every effort that was made to sell a hundred million dollars or more of municipal issues, with the exception of two instances, attracted only one bid. If we went into the long-term market with auctions, we do not believe that many institutions, the pension funds, the average man in the street, and the other fellows we would like to have as true savers, have yet come to the point of knowing sufficiently about this bidding arrangement that they are willing to risk their capital on a bid. I can assure you, however, that we will keep pursuing it.

The CHAIRMAN. The chairman has already taken much more than his share of the time. I will merely say in conclusion that we have never said that this should be done overnight, but we have said that the Treasury should move toward this policy, and that a letter of intent written in good faith, as I am sure it would be, would be very desirable. I think we need to make the Government bond market much less esoteric than it is now. At the present you have a limited number of 17 dealing in issues already out, not necessarily on new issues, but on issues already out, and the result is that it is a very poorly understood market. If you could broaden the knowledge and invite more direct participation and break through the present limited group who have access to this information and to the subscriptions, and then put it up competitively, I think you could remove any possibility of favoritism and of an excessively high interest rate.

Secretary ANDERSON. We would certainly welcome every new dealer we could encourage to come into the market.

The CHAIRMAN. Why not launch forth boldly and try to get them? Congressman Curtis.

Representative CURTIS. I am not so sure that my questions should be directed to the Secretary. I would like to ask this question, which is in the nature of a comment on those who are opposed to removing the interest ceiling on the long-term bonds. Even granted that other tools might be developed and used—and as I understand it that is their argument—is that a reason for depriving the Treasury of an obvious tool that they could be using right now?

Mr. Secretary, the question would be, Is there anything mutually exclusive about these various suggestions the chairman is making of

how you might improve the tools that you have to handle the Federal debt? Is there anything exclusive about those which would be a reason for not granting you the obvious tool that you could use; that is, remove the interest ceiling?

Secretary ANDERSON. We do not think so.

Representative CURTIS. I can't see it, either. I just don't understand the argument. So I will pass.

The CHAIRMAN. Senator Sparkman.

Senator SPARKMAN. Mr. Secretary, I have enjoyed the discussion. I think the chairman has very well covered the field as far as my questions are concerned. One or two thoughts run in my mind. We usually speak of removing the ceiling. It is my understanding that the administration's proposal is that the ceiling be removed completely. Is there any thought of raising the ceiling, rather than removing it entirely?

Secretary ANDERSON. I do not believe that is a satisfactory answer. If the ceiling were raised only slightly, it would, I think, have at least some effect of creating a magnet, pulling the rates toward the new ceiling, because it is public knowledge that we are going to have to finance the debt in any period of time within the limits of the prescribed ceiling. If we were to raise it so high that this was not possible, or not reasonable, then it would seem to me that the course of wisdom would be to remove it entirely. I know of only two countries in all of the world that have a comparable ceiling. One is Brazil and the other is Chile. The ceiling rates in those countries are set at 12 percent. It would seem to me that we start out with the basic principle that the Treasury of the United States ought at least to have as much capacity to manage a $290 billion debt as the ordinary company or corporation in this land would have in having access to other credit markets.

Senator SPARKMAN. I certainly sympathize with you in this problem of managing the national debt, and I think it is one of the most important problems before us today. I would want to see you have whatever is necessary to enable you to manage it. I think it is a reasonable assumption that there is considerable fear among the people that raising the ceiling or removing the ceiling would give an impetus here toward higher interest rates. I may say that I think that is based on the feeling that has developed over the years that this administration has purposely pushed up interest rates. I don't mean that all along it has been pushing up, but away back in the beginning, back in the early days of 1953, there was an arbitrary upward push of interest rates and that the momentum has not been completely lost yet.

Secretary ANDERSON. Senator Sparkman, as far as I am concerned, I have no desire to push up interest rates. I would have as an objective the financing of the public debt at as reasonably low rates as it could be financed in a competitive market.

May I illustrate by saying this: We now have a ceiling. If that ceiling were truly effective Government securities now selling in the market ought not to be selling above the ceiling. But they are selling at higher rates. Right at this moment, in markets all over the country, there are quotations on the securities of the United States, with most of them above the 4¼-percent ceiling. If we continue to pursue this

sort of policy, notifying the market, telling the world, that we are going to finance under 5 years, as long as we have high levels of business activity and high levels of demand against the supply of savings, you are going to keep pushing up short-term rates. The time may come—I think there has been some evidence of it already—that savers will say to themselves, why should I put my money into an institution of the type that furnishes mortgage capital for home building or any other long-term credit requirement, when I can buy almost without risk a 5-year issue of the U.S. Treasury with only a slightly lower rate of interest, or an even higher interest rate than I can get by risking my money out for a long time to come. If this sort of psychology should become widespread, you are going to have money drawn out of savings and loan institutions, mutual savings banks, the savings departments of commercial banks, all of the other forms of institutions which supply mortgage credit, and put into these short-term securities which are selling at a high rate of interest. Then you will finally have even higher long-term rates, and you will have less available long-term money.

If the Treasury is permitted to reasonably manage its debt, just the marginal effect of not being confined rigidly by statute to a certain area of financing would, in my judgment, have very salutary effects.

Senator SPARKMAN. Of course, we experienced the situation that you have just described with the Fabulous Fives; did we not?

Secretary ANDERSON. Yes, sir.

Senator SPARKMAN. Do you believe that if you were free to operate without the existence of the ceiling that you could stabilize the interest rates? Do you believe that they might come down some, rather than pushing up?

Secretary ANDERSON. I do not believe it is possible for anyone to make a categorical statement that he could stabilize interest rates. I think we could take the pressure off the short-term rates. When we issued the 5-percent notes, we had no choice. We have no choice at this time.

Senator SPARKMAN. By the way, let me ask you this: I must confess that I don't fully understand the operations even from your description, and I don't ask you to go into detail. What determined the setting of the 5-percent rate rather than 4⅞? Wouldn't they have sold at 4⅞?

Secretary ANDERSON. You would have sold some. You would not have sold as many.

Senator SPARKMAN. Didn't you have a great oversubscription?

Secretary ANDERSON. Yes; we did. Let me make this observation, Senator. While we might have sold, let us say for figuring, a billion dollars at 4⅞, we were able to market over $2 billion at 5. But more important, in my judgment, is not the difference of one-eighth of 1 percent but rather the fact that this was front-page news in many newspapers around the country. If we could put every offering of Treasury securities on the front page and give it the same kind of equal publicity, I would expect that we would have a growing interest in them.

Senator SPARKMAN. Even though the effect of your offerings as you described them a few minutes ago would be at least temporarily adverse in the home mortgage field, and similar fields, relying upon

the various savings institutions, would it not be a good practice to try to encourage more widespread participation in Government bond purchases?

Secretary ANDERSON. Senator, the savings bonds——

Senator SPARKMAN. Including individuals.

Secretary ANDERSON. Through the savings bonds we have the largest voluntary organization in the world trying to encourage investment among the people.

Senator SPARKMAN. With the lowest rate of interest?

Secretary ANDERSON. Yes, as far as other securities are concerned, because they are a different kind of instrument.

Senator SPARKMAN. And with other disadvantages?

Secretary ANDERSON. But they have advantages over the others. They are really more like savings accounts than marketable securities.

Senator SPARKMAN. They do have some advantages, but they have disadvantages, too. I think one of the disadvantages has been the fact that whereas other bondholders, or at least many other bondholders are given the right to participate in these issues at a higher rate of interest, that right has never been extended to the defense bond holders.

Secretary ANDERSON. Senator Sparkman, anybody in this country can buy one of our marketable securities.

Senator SPARKMAN. Yes; I know it, but suppose I want to buy one of your Fabulous Fives and I am holding a 3¼ percent savings bond that has been souped up now, and I want to buy, I don't have the privilege that the ordinary bondholder has of simply exchanging it. I have to sell mine, pay an income tax on the increase, and then employ a broker to buy the bonds for me.

Secretary ANDERSON. Senator, in the original issue of Government securities, anybody can buy them who wants to send in a subscription to any of the Federal Reserve banks or branches all over the country.

Senator SPARKMAN. Individuals?

Secretary ANDERSON. Individuals; yes, sir.

Senator SPARKMAN. Individuals can do that?

Secretary ANDERSON. Yes, sir. In the case of the 5-percent bonds, about 100,000 people did it.

Senator SPARKMAN. I realize that was open to the public.

Secretary ANDERSON. They all are.

Senator SPARKMAN. I don't believe it is generally known. I don't believe the people generally are familiar with the operations to the extent that they participate in anything like they do in the purchase of defense bonds, for instance. That has been a well-advertised program that the people have learned about.

Secretary ANDERSON. Yes. Let me point out that there are certain differences in characteristics. If you take a savings bond and lose it, you can replace it. The Government guarantees with good times or bad that the rate of interest on this security will remain outstanding for whatever period of time it commits itself for. It gives you privileges of redemption by simply taking them down to the bank and turning them in. In the marketable security we are very desirous and anxious for people to own unregistered marketable securities, but we want them to know what they own. They own in many instances an unregistered piece of paper which, if they lose it, they sustain the loss.

They own a piece of paper on which the United States does not guarantee the par value of the instrument throughout its life, but the instrument fluctuates in market value.

Senator SPARKMAN. Except at maturity.

Secretary ANDERSON. Yes; except at maturity. It fluctuates in the market.

Senator SPARKMAN. In your savings bonds, a person who cashes it in prior to maturity is heavily penalized. However, I don't care to argue that point, Mr. Secretary. The only point I was making is that it seems to me that a wider participation would be helpful. I want to see something done whereby you can manage this debt, because I think it is one of the most important jobs that we have to do. I think that the American people want to be assured that whatever is done will retain some resiliency in the interest rate, and we won't get on this high plateau and stay there forever. I can go on questioning but I will defer any further questioning.

The CHAIRMAN. Senator Bush.

Senator BUSH. I have about three areas of questions, Mr. Secretary. In the first place, regarding the methods of offering Government marketable securities, do you have any complaints from the savings institutions and the financial institutions that invest in these securities, that is, they account for a very high percentage of investment in marketable securities. Have they registered complaints with the Treasury about the way the offerings have been made or the method of offerings?

Secretary ANDERSON. No, sir; not to my knowledge.

Senator BUSH. In other words, as far as you are aware, the procedures that you are following are broadly satisfactory in the market for Government securities?

Secretary ANDERSON. Yes, sir.

Senator BUSH. Now I want to ask you this question: What about callable bonds? Suppose you were to issue today some 20-year, 5-percent bonds, and 5 years from now, let us say, the market had changed substantially, and if those bonds were callable, you could refinance them on a $3\frac{1}{2}$-percent basis. Do you have the authority now to issue callable bonds?

Secretary ANDERSON. We have that authority; yes, sir.

Senator BUSH. Is that an authority which the Treasury has used from time to time?

Secretary ANDERSON. It has.

Senator BUSH. It has?

Secretary ANDERSON. Yes, sir.

Senator BUSH. So that the argument that is often heard—and I heard the chairman suggest it this morning—that if you issue a high-coupon bond right now or a high-yield bond of long maturity now, that we live with it forever, is not necessarily a valid argument, because that issue, if callable, could be refunded as is done in other offerings, such as municipal offerings, corporate offerings, and so on. Does the Government have the freedom to use the callable bond so as to take advantage of lower markets or better markets at a later time if they want to refund?

Secretary ANDERSON. Senator Bush, we have given a great deal of consideration, and will continue to give consideration to the issuance of bonds with callable features if market conditions in our judgment

so warrant. I think in the first place I should point this out very clearly. If you take off this ceiling completely, the Treasury has no intention of issuing large amounts of long-term bonds for cash at high interest rates.

Senator BUSH. You probably could not do it if you did.

Secretary ANDERSON. We would not do it because we would not want to so drain off savings which might be used or required for maintaining sustainable growth in this country. Large issues would take a disproportionate share, of the Nation's savings. Let me point out in the years from 1953 through June 1959, only 10 billion of securities running 10 years or more to maturity were issued. This is an average over the 6½-year period of about 1½ billion per year. I think, also, when we examine this thing that we have to look at the fact that in the 5- to 10-year maturities, which is the intermediate range, some $40 billion have been placed in the intermediate range since 1952.

Now the desirability of the callable feature in the intermediate range would be much less than the desirability of the call feature in the long range.

Senator BUSH. Have you issued callable bonds in the long maturity in that 10 billion?

Secretary ANDERSON. In 1953, one issue was issued.

Senator BUSH. What was the rate on that issue?

Secretary ANDERSON. 3¼ percent. I think in determining the advisability we have to recognize in the first place that the call feature tends to make the security less attractive. It tends to be traded in the market on the basis of when the call can be exercised. There would have to be some additional rate of interest fixed or you would have to follow the procedure that is normally followed in the corporate field of calling at premiums, and the Treasury has not paid premiums in the past. The long-term investors, I think, would buy the callable securities only if they felt that the increased interest which the borrower was willing to pay for the call feature was sufficient to compensate them for the loss of future earnings if the bonds were called. All of these things have to be weighed. A good many of the bonds which in our history were issued in peacetime on a callable basis were issued when debt was fairly small, when the savings type of institutions which are now interested in meeting their actuarial requirements by buying Governments, were just in the formative period. We are now dealing in a market in which at least some of the purchasers of our long-term securities are much more interested in the ability to meet their acturial requirements than having a security which does not fluctuate as widely in the market.

Senator BUSH. Mr. Secretary, on the subject of the level of the interest rates, I have two questions. The first one is this: How does the level of interest rates in the United States compare with that in other countries throughout the world or in the free world?

Secretary ANDERSON. It is among the lowest.

Senator BUSH. Among the very lowest?

Secretary ANDERSON. Yes, sir.

Senator BUSH. Would you give to this committee for insertion in the record a table that would show comparative interest rates at this time, or at the time of this hearing?

Secretary ANDERSON. Yes, sir.

Senator BUSH. So we can have it for reference.

(The table referred to follows:)

Interest rates in selected countries[1]

[In percent per annum]

	Yields on long-term Government bonds		Yields on long-term Government bonds
Australia	4.89	New Zealand	4.15
Belgium	4.22	Norway	4.57
Canada	5.60	Sweden	4.44
Denmark	5.60	Switzerland	3.25
France	5.07	Turkey	4.85
Germany	[2]	Union of South Africa	5.25
Italy	5.37	United Kingdom	4.99
Japan	[2]	United States	4.27
Netherlands	4.21		

[1] December 1959 or nearest date thereto.
[2] Not available.

Senator BUSH. Finally, I want to ask this question, Mr. Secretary. One hears a great deal of conversation about the so-called tight money policy of this administration. I have always contended that there was not any such policy of this administration; never had been at any time; that the administration has had consistently a sound money policy. But never has the administration moved aggressively or on the offensive to attempt to make money tight as a policy of this administration. Would you comment on that as you have seen it yourself since you have been Secretary of the Treasury and before that, if you wish?

Secretary ANDERSON. In the first place, the monetary management problem is primarily a problem of the Federal Reserve, rather than the Treasury. I should like to point out, however, that if one looks at 1959, the total credit and equity market instruments grew $60 billion.

Senator BUSH. Say that again.

Secretary ANDERSON. $60 billion.

Senator BUSH. Did what?

Secretary ANDERSON. Total credit and equity market instruments grew in 1959 by $60 billion. That is approximately a third more than the previous peacetime record set in 1958. Now, one of the things that supports a high rate of savings in this country, and therefore availability of money in the markets, is whether or not the people believe that we have the will and the power and the courage to maintain the value of their money so that they can afford to save it in the fixed dollar forms that have been traditional in our country. In the use of this $60 billion let us look at the position which the Treasury has occupied, and not only this $60 billion but that which has gone before.

During the past 2 years the Treasury has issued $4.5 billion of long-term securities over 10 years to maturity. During the same period of time the total mortgage debt outstanding has risen by approximately $35 billion, or about eight times the increase in the Government securities of comparable maturity. New bonds issued by business corporations are estimated to have totaled about $16 billion, or 3½ times the Government bonds. Securities issued by State and local governments are about $16 billion, also about 3½ times more than the long-term Government bonds. So what we are trying to do is to achieve a high

rate of savings in our country to encourage people to believe, as I think they should believe, that they take no great gamble or risk in their savings, that these savings then are made available in the competitive markets in which, while we are the single biggest customer, when one looks collectively you find that the collective use of long-term credit by others is much greater than ours. All that we are asking to do here in trying to remove the interest-rate ceiling is to be allowed to compete in a very modest way for cash, and to be allowed to try to secure some rearrangement of a debt that grows constantly shorter and shorter and shorter by the passage of time. I should like to point out in November of next year, 1961, whoever sits in my responsibility, or whoever the President of the United States is, is going to be confronted with refinancing something over $11 billion worth of publicly held securities. We simply do not have the kind of market facilities in this country that can handle this order of magniture of a public refunding without very difficult problems. If we had the capacity to exceed the ceiling, we ought to now be relieving—at least in part—some of the huge bunching of the debt as is characterized by the November refunding of next year. I don't mean taking money out of the market which is available for other purposes, but exchanging on a par-for-par basis with at least some of the investors who are true long-term investors, and who would be willing to take longer term securities as a matter of advance refunding, and at least modify this tremendous job that will be faced in 1961.

Senator BUSH. Thank you, Mr. Secretary.

The CHAIRMAN. Mr. Widnall.

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Secretary, I recently visited Europe with a congressional committee, and we talked with the finance ministers of many countries. They expressed a fear about inflation which certainly has been the same type of fear that the administration has expressed rather forcibly throughout the United States. I found that they worried about us because they did not believe that here in the United States the evil of inflation was realized the way it should be. They said, we never had undergone the drastic inflation that all of their countries had gone through.

Do you find in your talks with finance ministers of other countries that they expressed that fear to you?

Secretary ANDERSON. Congressman, I believe that we enjoy the confidence of the world, the confidence of central banks and finance ministers, but I think the important thing which we have before us it to maintain that confidence. The American people must come to a realization, in my judgment, that we now occupy a position which is unique in our history. We have become the bankers of the world, with approximately $9 billion in the accounts of foreign central banks and governments, and approximately $7 billion in the hands of foreign banks, individuals, and corporations invested in short-term-credit instruments of the United States plus $1½ billion invested in longer term U.S. Government bonds and notes. If we look at the other side of the coin and add up all of the debt that is owing to us, all of the foreign investment which has been made abroad, on which we earn an income in foreign exchange through profits and earnings and dividends in the future, this was equal to almost $59 billion at the end of

1958. But we have come to occupy the traditional role of the bank in that we borrow short and we lend long. We have come to assume another important position in the world affairs, and that is in every period of the world's history some country has to furnish a reserve currency in order to have enough international liquidity that the whole stream of business and commerce around the world can be carried on. The dollar has now become the world's reserve currency for the most part. If ever we should impair in any degree whatsoever the reserve characteristics of our currency, we would have affected the world's liquidity, not only by the extent to which we allowed impairment of our own currency but the extent to which they were willing to continue to hold and to use our dollars as a reserve currency. These are grave responsibilities.

I think that for the foreseeable future we must know that other countries are going to be examining what we do in terms of budget policy, fiscal policy, monetary policy, debt management, the relative equilibrium between cost and productivity, the kind of decisions that are made in a free market economy, to determine whether or not this confidence which now exists and which rightly exists will continue to the high degree that is necessary. It is an added emphasis as to why we ought to have flexibility in the management of the debt so that we do not notify the world that we have embarked upon a policy of deliberately shortening the marketable debt of the United States.

It is a reason why we have to be prudent, thoughtful, and careful in all of our other activities. Mr. Erhard of West Germany said in December that "if the economic sun, the dollar, around which the other currencies of the world revolve, should ever begin to move, which God forbid, the consequences for the West would be unthinkable." It seems to me that we have only to do those things which the economic lessons of history have taught us are sound and practicable, to live up to the responsibilities and the disciplines of a free market economy, and we will have measured up to the true role of economic leadership which we have in the world and which we currently enjoy.

But I think that we are going to be under observation to be sure that we do measure up in that respect.

Representative WIDNALL. Mr. Secretary, in talking with these ministers of finance, they all could not understand why we maintained the ceiling on financing our long-term Government debt. None of the countries had that type of ceiling, and they could not understand how we would try to make our own debt management so difficult willfully.

Secretary ANDERSON. I have had similar inquiries.

Representative WIDNALL. I am going to place in the Congressional Record today a front-page article from the New York Times of February 13, 1960. It says, "Europeans Cite Inflation Fears—Wage-Price Spiral Called Bigger Peril Than Slump." This is exactly what they told our congressional committee wherever we went about their fears for the future. I think it is very important that the American people understand that we are being watched by all these countries, because they realize how their economies hang on ours, and how they are tied in with ours. Thank you very much.

The CHAIRMAN. Mr. Secretary, I have been very much moved by your quotation from Chancellor Erhard, or rather Foreign Minister

Erhard, about how he is fearful about the American dollar. I would suggest that Mr. Erhard and the others, if they are so fearful of the American dollar, pay for the airplanes which we now furnish them without charge. It would also suggest that West Germany assume a larger share of the costs of NATO. That Germany contribute to the economic support of India. That Germany contribute to the economic support of India. That Germany aid in the armament of Turkey. I understand that the President is sending up today a foreign aid bill of $4.1 billion, which is approximately the same amount as 1951. It would seem to me that if the foreign countries are so solicitous about the American dollar that they could get under the load and Congress could contribute to the stability by cutting the President's appropriation for foreign aid by at least a billion or a billion and a half, and thus reduce the strain upon the American dollar about which these Europeans are so fearful, but about which they seem not inclined to help. That is a comment, Mr. Secretary.

Now, may I ask a question?

Representative CURTIS. Can we comment on the question?

The CHAIRMAN. It is not a question. It is a comment. If the Secretary feels moved to answer under the 10-minute rule, I will be glad to have him do so. I don't wish to shut him off. I am merely touched by the way these European finance ministers weep over the financial status of the United States, when we have borne the heavy burden of restoring their economies.

Secretary ANDERSON. Senator Douglas, in the first place, I would not like to have the minister's remark construed as being fearful. I think he was merely pointing out the degree to which the currency of the United States has become a reserve currency around the world. I do not believe that either he or anyone else has any fears or doubts about our currency, and I think as a matter of fact in the past several months the degree of confidence in currency has had a marked improvement.

The CHAIRMAN. May I inject if these fears are fictitious, they should not weigh in the decisions which we make in the United States; is that correct?

Secretary ANDERSON. Let me respond by saying that I share with the Senator the feeling that those countries which have experienced economic recovery since the war should assume a larger share of the burdens.

The CHAIRMAN. Doesn't that mean West Germany?

Secretary ANDERSON. It means West Germany as one country.

The CHAIRMAN. Couldn't it mean Great Britain?

Secretary ANDERSON. It means all of those countries which have had a degree of economic stability. What one does in the circumstances is not to avoid those things which we do for our mutual protection nor to avoid doing those things which as a large and progressive country we should do for the less developed countries of the world on the military or economic front, but we should insist, as we have done, that the discriminations which we tolerated against the import of dollar goods into the industrial countries of Europe for a number of years when they were suffering from a dollar gap should be removed, and I would say that a great deal of it is being done.

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The CHAIRMAN. Are there not still discriminations against American goods under quota systems which probably cut down our exports by $600 million a year?

Secretary ANDERSON. There are some, but they have been very significantly reduced in the past few months.

The CHAIRMAN. Doesn't West Germany have a large number of quota restrictions against the American goods?

Secretary ANDERSON. I do not know the extent to which they continue to hold. We must do all we can to be of assistance to the people of our country through whatever credit mediums are practicable, and workable, to increase our own exports. Above everything else, we must avoid the inflation which prices our goods to a point where other people are unwilling or unable to buy. The real long-term answer is to increase the multilateral trade and exchange between the world and not to develop other kinds of restrictive policies.

The CHAIRMAN. May I return now to some of the more technical financial questions? You stated in response to a question from our friend from Connecticut that the Treasury had issued callable bonds. When was the last issue of callable bonds?

Secretary ANDERSON. May 1953.

The CHAIRMAN. That agrees with my figures, too. So in the last 7 years, although you have had the power to issue callable bonds, you have not done so. What some of us have suggested is that you issue in your letter of intent to Congress, which we hope will be forthcoming, a pledge that you will make the bonds callable in the future. I am quite prepared to admit that this may lead to initially a slight increase in the cost of financing. That is true. But the ultimate protection against a high initial interest rate which later subsides would be very great. I hope we can get a pledge from you, Mr. Secretary, that you will use this power which the Treasury has had for almost 7 years which it has not employed.

Senator BUSH. Would the Senator yield?

The CHAIRMAN. I notice whenever I ask a question, my colleagues interject, though I never interject during their time. I never do. But I will yield to the Senator from Connecticut.

Senator BUSH. This is so interesting that I have to ask a question.

The CHAIRMAN. The Senator from Connecticut is very interesting, but I observe the rules of deportment and do not interject when he is asking a question.

Senator BUSH. The Senator has not always observed the rules of deportment.

The CHAIRMAN. I try.

Senator BUSH. If the Treasury would indicate that it would offer callable bonds, would the Senator advocate removal of the interest rate?

The CHAIRMAN. I have said that if we could have a thoroughgoing pledge of reform and an assumption of fiscal responsibility by the Treasury and by the Federal Reserve then we can consider this matter. What I am really doing is feeling out the Secretary to see if he is in a mood to reform on these matters, on callable bonds, auction system, and so forth, and various other proposals, such as, for instance, floating longtime bonds when interest rates are low rather than when they are high. We are engaged in a probing operation.

Senator BUSH. The Senator's definition of the word "reform" is interesting at this point. I would not want to see the Secretary retrogress in his policies.

The CHAIRMAN. I want to see the Treasury reform. I hope this colloquy between the Senator from Connecticut and the Senator from Illinois will not be charged to the Senator from Illinois.

Senator BUSH. By no means.

The CHAIRMAN. Thank you.

Secretary ANDERSON. Senator Douglas, I do not believe it would be appropriate for me to make any announcement as to the type of security the Treasury was either going to issue or was not going to issue. I will say to the Senator that we are fully aware of the fact that we have the power to issue callable bonds.

The CHAIRMAN. In other words, you call upon us to surrender, and then you say you will study the matter. Do you believe in unilateral disarmament, Mr. Secretary?

Secretary ANDERSON. It is not that, Senator, as it is that I do not believe in advising the market in advance precisely what the Treasury is going to do.

The CHAIRMAN. Or telling Congress in advance what your policy is, either.

Secretary ANDERSON. The one thing that I would like to emphasize, Senator, is that if the ceiling is taken off——

The CHAIRMAN. We are well aware of that. We know that is your desire.

Secretary ANDERSON. If the ceiling was taken off, we would not have any intention of issuing large amounts of long-term bonds at high rates for cash.

The CHAIRMAN. Mr. Anderson, my memory is not perfect, but I seem to remember, subject to correction, a speech by Under Secretary Baird a little time back saying it was the intention to refinance $20 billion of bonds. Is my memory in error on that point?

Secretary ANDERSON. Secretary Baird's statement was, as I recall it, that over the next few years we would hope to extend about $20 billion essentially through the method of advance refunding. Senator Douglas——

The CHAIRMAN. In other words, to refund $20 billion.

Secretary ANDERSON. Advance refunding.

The CHAIRMAN. At what premium? I understand there is a proposal to turn in, let us say, $9 billion of short-time paper and get back $10 billion in return at an interest rate which does not exceed 4¼, but that premium would raise the actual payment well above 4¼.

Secretary ANDERSON. No, Senator——

The CHAIRMAN. So these gimmicks of advance refunding have to be watched very carefully and when Under Secretary Baird said $20 billion to be refunded, even though the word "advance" was put in front of it, I had the feeling, and I think it is justified, that this proposal was not a minor one, such as you have represented it to be, but that it represented a major refunding by the Treasury. I am very glad that my memory was not in error on Under Secretary Baird's statement.

Secretary ANDERSON. Here is his quotation.

I hesitate to specify an exact figure, but, if, in addition to the extension required to keep even with the erosion caused by passage of time, we were able, over the next 2 or 3 years, to move something of the general magnitude of $20 billion out of the 1 to 5 year area into longer maturities, it is our judgment that we would have a reasonably satisfactory structure of the marketable debt.

The CHAIRMAN. Mr. Secretary, may I make a reply to that? When was that speech delivered?

Secretary ANDERSON. October.

The CHAIRMAN. 1959?

Secretary ANDERSON. Yes.

The CHAIRMAN. So the plan was by October 1961 or October 1962 to refund $20 billion.

Secretary ANDERSON. This would be the ideal goal. We may not achieve it. Also, if we did not get the authority, then we would have to move the timetable forward.

The CHAIRMAN. We know that you strain after the ideal.

Secretary ANDERSON. Yes. I fear there is some misunderstanding about this advance refunding. May I run through just what we would have in mind as a typical example?

The CHAIRMAN. I would be very glad to do that, Mr. Secretary, but may I ask another question first?

Secretary ANDERSON. Surely.

The CHAIRMAN. You know the practice of filibustering is not confined to the floor of the Senate. I want to return to the question of oversubscription of the so-called Fabulous Fives. Are my figures correct that you offered $2.3 billion of this bond?

Secretary ANDERSON. We offered $2 billion.

The CHAIRMAN. $2 billion.

Secretary ANDERSON. We allotted $2.3 billion.

The CHAIRMAN. You allotted $2.3 billion?

Secretary ANDERSON. Yes.

The CHAIRMAN. Am I correct that the total amount of subscriptions amounted to $11.1 billion?

Secretary ANDERSON. Yes, sir; approximately.

The CHAIRMAN. So my figures are correct, or the amount subscribed was approximately five times the amount offered. In an ordinary competitive market wouldn't this indicate that the price which you charged was too low where you have five times as much demanded as is offered? In any ordinary competitive market wouldn't this mean that the price was too low, and if you had competitive bidding for those bonds that the price would be higher and hence the yield lower and hence the real interest rate lower?

Secretary ANDERSON. Senator Douglas, it seems to me the more important thing would be to look at what happened to these bonds in the following market.

The CHAIRMAN. I am speaking of that initial offering.

Secretary ANDERSON. The number of subscriptions which you get will largely depend upon the number of people who may want to participate in the market, although not to the extent that they would put in their bids because traditionally people have put in very much higher bids in the knowledge that there is going to be some determination on the part of the Treasury in allocating smaller amounts.

The CHAIRMAN. Mr. Secretary, let me say that I grant, of course, that there is an exaggeration in the amount of the oversubscription. Yet the very fact that people have put in more than they expect to get is an indication that there is a general belief that there is a real amount of oversubscription that is going to take place, that is what you describe as a secondary effect. It does not remove the primary fact that a greater quantity is demanded at the par price which you charged than is offered.

Secretary ANDERSON. Senator, if these were so very badly overpriced one would expect within following days the 5-percent securities would not have remained anywhere near par, but would have gone very much above par. Because all of these people who did not get what they wanted to buy would be coming in to bid up the price. But if you will examine the history of these 5-percent securities, they stayed reasonably close to par for a very long time and the greatest increase that they have had is in the recent weeks when there has been a general decline in interest rates.

The CHAIRMAN. What are they selling for now, Mr. Secretary?

Secretary ANDERSON. They are selling at 101.18 last night.

The CHAIRMAN. So there has been an increase of 1.18 percent. When were they issued?

Secretary ANDERSON. These were selling at 101 plus 18/32.

The CHAIRMAN. Eighteen thirty-seconds I see. So that is really 1.6-percent increase. When was the issue?

Secretary ANDERSON. October of last year.

The CHAIRMAN. I would say they have done pretty well to make a 1.6-percent gain in the space of a little over 3 months.

Secretary ANDERSON. This is again just the normal fluctuation of demand and supply.

The CHAIRMAN. Why not let demand and supply operate when you sell the bonds instead of not permitting demand and supply to operate?

Secretary ANDERSON. Senator Douglas——

The CHAIRMAN. What you do is to have a fixed interest, fixed maturity, fixed price. There is no variation in that whatsoever.

Secretary ANDERSON. The extent to which we can utilize the auction as I already pointed out, we are perfectly willing to try to extend it. We have pointed out the difficulties that we encounter when we try to get into issuing billions of dollars of long-term marketable securities.

The CHAIRMAN. You can build up your market.

Secretary ANDERSON. We will try, sir.

The CHAIRMAN. Is this a pledge?

Secretary ANDERSON. It is a pledge to do all that I can to build it up; yes, sir.

The CHAIRMAN. Will you issue a letter of intent along with this that you intend to push for auctioning callable bonds, and also broaden your markets so that institutional investors and private investors can participate?

Secretary ANDERSON. Senator Douglas, I do not wish to issue letters of intent.

The CHAIRMAN. Now you are depriving me of a chance to go along with you, Mr. Secretary. You are very intransigent.

Secretary ANDERSON. I will say to you that we have used the auction technique more than it has been used in many years.

The CHAIRMAN. Under the promptings of this committee.

Secretary ANDERSON. For whatever the reason, we have used it. We will continue to try to improve it. We will continue to interest individuals in our securities. We will continue to take all of the pros and cons of the market into consideration with reference to the callable bond. But I do not wish to make direct statements of intent or specific things or specific purposes, because I don't think this is consistent with my responsibility.

The CHAIRMAN. Mr. Curtis, did you wish to inquire?

Representative CURTIS. Yes, just on this one point that the Senator was making under the prompting of this committee. I trust that the Treasury does things primarily because they have come to the conclusion that is the correct thing to do.

Mr. Secretary, as I understand your answer to Senator Douglas on this auction, it is that you are attempting to test out that as a method of handling the sale of securities, is that not right?

Secretary ANDERSON. For example, we——

Representative CURTIS. I think you have already stated it.

Secretary ANDERSON. Yes.

Representative CURTIS. I listened carefully to your statement. Obviously the Senator was not listening as carefully. I think if he rereads it, he will find it is a pretty good statement on your part on the new use of auctioning, and the fact that when you went to your 1-years, you found on examination there is a real question of whether that can be extended too much further, and that it deserves some honest appraisal on the part of this committee, I might say, as well as Senator Douglas, and yourself, because it is possible that this technique cannot be extended profitably. I don't know.

Secretary ANDERSON. We will be willing to extend the auction principle as far as we believe it can be practically utilized. We have already introduced two new cycles of auctions in the 6-month and 1-year bills. We realize upon examination that we have paid some extra cost in interest rate for this auction principle. This does not mean we abandon it. It simply means you have got to continue to try to educate and to increase the number of people who are willing to come in and buy the marketable securities, in the knowledge of what kind of instrument they are buying and to take their risks in the competitive bidding.

Representative CURTIS. I want to commend the Treasury on this and say that I as one member of this committee, at any rate, am going to go over carefully the statement that you have given us of your experience in this field. I hope our staff will study and let us understand the complexities of this problem and the difficulties, as well as the features that led us to suggest that as a technique.

Mr. Secretary, I wanted to ask you one thing. When you were mentioning the fact that you did not want to issue a letter of intent, and so forth, you said that you thought as a matter of policy it was not good for the Treasury to tell the market what you were going to do or what the Treasury was going to do. I suspect the chairman of this committee subscribes to that as a policy. I wonder if I could ask that question.

The CHAIRMAN. What was the precise question?

Representative CURTIS. Whether or not you agreed with the Secretary's statement that it is not good policy on the part of the Treasury to let the market know what the Treasury is going to do.

The CHAIRMAN. I don't think they should let the market know the interest rate, although generally the market does know pretty well, because the recommendations of the bankers committee is followed in 85 percent of the cases by the Treasury so they generally know what they recommend is going to be adopted. Nevertheless, I agree that they should not let them know about the interest rate you intend in advance. But I say that it would be vary helpful to the taxpayers and to legislators if the Treasury were to issue a letter of intent saying that they intend to use the auction system on longtime bonds in the future as well as short time. That they will have callable features attached to the bonds, and that they will do their long-term financing in periods of low interest rates rather than in periods of high interest rates.

Representative CURTIS. That gives me the context that I need to ask this question. It would seem to me, then, that we are agreed that the more flexible the Treasury is, and the more variety that it has, the better position the Treasury is going to be in getting the best of the market. The question is this, Mr. Secretary, with this interest ceiling, aren't you actually in the position of tipping your hand to the market that you are going to have to finance in the short-term field?

Secretary ANDERSON. The market has been very well aware of the limitations on the Treasury since the long-term rate was placed at 4¼ percent.

Representative CURTIS. It is exactly the kind of tipoff which you feel is bad, I presume.

Secretary ANDERSON. I would say on the three points that Senator Douglas raised, in the first place, I will do all within my considered judgment to improve the capacity of selling marketable securities at auction wherever we believe that it is practicable, and in the Nation's best interests. We will not rule out consideration of any of the authorities which we have and numbered among those is the authority to issue callable bonds. We will be guided by what we think will be market conditions, market acceptance, the rates of interest that we would have to pay, and all other factors and considerations which I think I have to exercise when I sit down to decide upon an issue. I would be very much concerned on the last point because it seems to me that if the Treasury should embark upon a policy of notifying the world that you were going to sell long-term bonds when interest rates were traditionally low that one would have to be aware of the fact that the low rate of interest is normally a reflection of the supply and demand operating at a time when the level of business activity is relatively low. This would be like saying that the Treasury would be concerned primarily with its rates of interest and to a degree should ignore the state of the economy, when at low periods of economic activity it is highly desirable that the Treasury should not absorb the long-term funds that would be available for plant expansion and for other things which would bring about a recovery. While corporations and others may borrow with only their cost of money in mind, the

United States, I think, has to borrow with the welfare of the whole country in mind and the impact which we might be having upon it. The Treasury was very strongly criticized by members of the economics profession for selling even a modest amount of long-term securities in the recession of 1957 and 1958. I believe each time we go into the market we must concern ourselves with the price we are paying for money. We must also concern ourselves with the state of the economy, and not too seriously impinge upon the available credit which would be used either for coming out of a recession or of maintaining growth.

I might cite, for example, that Prof. Seymour Harris in testifying before the Senate Finance Committee in April 1958 said, and I quote:

> The policy of selling long-term Government securities in the midst of a recession is foolish and costly and should be stopped once and for all. The securities compete with private enterprise and keep rates up.

Representative CURTIS. I wonder if the Senator from Illinois would not take that as a good substitute for a letter of intent.

The CHAIRMAN. No, I am afraid I would not.

Might I be permitted to reply?

Representative CURTIS. Certainly.

The CHAIRMAN. I think you touched the nub of the difference of opinion. It is the judgment of some of us that because of failure to adopt an adequate fiscal policy both on the part of the Executive and on the part of Congress, and because of the failure of the Federal Reserve to adopt the proper monetary policy that functions have been heaped upon debt managtment which would not be properly thrown upon debt management. I do not regard it as a function of debt management to stabilize the economy. I think that the economy to the degree that it can be stabilized should be stabilized by tax policies and expenditure policies, taxes rising in periods of prosperity, falling in periods of recession, and expenditures rising in periods of recession and falling in periods of prosperity, and accompanied by proper monetary policy. But debt management I think should be confined to relatively narrow limits; namely, obtaining for the Government adequate credit, properly spaced, at as low a cost to the taxpayer as is reasonably possible. My grievance against the administration is that it has given us no lead whatsoever on fiscal policy. It has declined to make any real recommendations on plugging the loopholes. It failed to meet the recession of 1957–58, as it previously failed to meet the recession of 1953–54 by adequate fiscal action, and that the monetary policy during this period was also inadequate.

Now you heap upon debt management this duty which I think is not part of its duty whatsoever. The net effect of this is to increase the interest charges to the Government, because, Mr. Secretary, may I remind you that though this administration came into power with the stated pledge that it intended to lengthen out the debt, and the Under Secretary of the Treasury, Mr. Randolph Burgess, made 1952 to June of last year, 2 days before you sent up your message requesting the lifting of the ceiling, the average duration of the debt declined from 5 years 9 months to 4 years 8 months. So here in a period of 6½ years, during which the debt was shortened. As you will see, there were intervals in these years in which interest rates were falling. There was a period of falling interest rates in 1954, another period of falling interest rates in 1958. You did lengthen it some-

what during that period, I grant you that, but not sufficient to overcome the long-time downward drift in the duration of the debt. I hope you will forgive me if I say this. Then you have a drunkard's repentance at the last minute and come in saying that the debt is unduly shortened when you and your predecessors slept on the job for over 6 years.

Secretary ANDERSON. May I inquire——

The CHAIRMAN. Those are severe words but they are justified.

Representative CURTIS. This is still my time so I want the Secretary to reply to that. I might make this one comment. I don't understand the logic of the Senator from Illinois, pinning all this on one thing, the interest ceiling on the long-term securities which is the only way in which you could lengthen the debt.

The CHAIRMAN. Mr. Secretary, don't misunderstand me. May I say I meant nothing personal in my comments.

Secretary ANDERSON. I understand that.

The CHAIRMAN. I was referring simply to behavior and not to character. I have the highest esteem for you as an individual, Mr. Secretary. I have often said that you are the most courteous and gentlemanly Government witness that I have seen up here in my 11 years on the Hill.

Secretary ANDERSON. Senator Douglas, from the end of the war, commencing 1945 to 1951, the Treasury issued no marketable securities for more than 5 years. In 1952, two issues totaling about $5 billion were marketed with 5 years or so to maturity. From the end of 1952 to the present the Treasury, in order to try to lengthen the debt, has issued $49 billion of over-5-year securities, including about $10 billion of over-10-year maturity. However, the average length of the marketable debt—reflecting the passage of time on outstanding issues—dropped from 5 years 3 months at the end of 1952 to 4 years 3 months in February of 1960. If nothing but under-1-year securities are issued in the next 18 months the average length in June 1961 will be about 3 years 9 months.

The CHAIRMAN. I have the Treasury Bulletin of December, page 21, and the bottom table says at the end of the fiscal year or month the average duration debt was 5 years 8 months in 1952; 1st of June 4 years 7 months. If I can subtract, that is a decrease in the average duration of 1 year 1 month; am I in error?

Secretary ANDERSON. No, Senator. I am quoting calendar year figures, and you are quoting fiscal year figures.

The CHAIRMAN. What was the duration at the end of calendar year 1952?

Secretary ANDERSON. At the end of December, 5 years 3 months.

The CHAIRMAN. Then there has been a decrease from 5 years 3 months to 4 years 7 months or a decrease of 6 months during this period.

Secretary ANDERSON. This is precisely one of the reasons, Senator, that I am hopeful that the Congress will give us authority to do some advance refunding by eliminating the 4¼-percent ceiling.

The CHAIRMAN. Don't you think the Treasury is mistaken in its policy prior to this time in not refunding during the period when interest rates were low? Now you come in when interest rates have been high, we are not certain they are going to continue so in the

future, and you were not hampered by a ceiling in those days. In 1954 the yield on Governments was less than 3 percent. You had ample room. In 1955 you had ample room. The actual yield was less than 3 percent. You had ample room in 1956. You had ample room even in 1957. Then with the fall in rates in 1958 down close to 3 percent, again once more you had ample room. It is only when this interest rate begins to go up that you want to refund. Why didn't you do it beforehand?

Secretary ANDERSON. Senator Douglas, in the year 1958 we extended $15.6 billion.

The CHAIRMAN. In spite of that the average duration declined.

Representative CURTIS. Surely, because of time.

The CHAIRMAN. For instance, in 1956 the average duration was 4 years 9 months, but by June of 1959 it was down to 4 years 7 months.

Representative CURTIS. Let me see if I can get this straight, Mr. Secretary. I thought your testimony was—and I wrote the figures $49 billion—that you were able to issue that amount of long-term during this period. As I understand this picture, the situation has been passed over to the Treasury. The debt was a certain complex in 1952, when you took over. You are dealing with a situation in which, if nothing were done, the average duration probably would be down much more. I think the case here is quite clear that the Treasury has done a certain amount. The question is whether it might have done more.

Mr. Secretary, I would like to get to this other point, and this is in context—much more in context. As I understand you had in mind, or have in mind, the possibility of advance refunding rather than issuing long-term securities for cash. But that in effect, if it were done now, would require discounting and you feel that although there might be authority to discount, certainly with a combination of the interest ceiling that we presently have and your feeling that there is a possible cloud on the ability or the legal ability of the Treasury to discount, you cannot do advance refunding along that line without Congress moving. Is that correct?

Secretary ANDERSON. We consider that we are bound both by yield and by coupon. So long as we are bound in both ways we cannot do advance refunding with the yield on long-term Government securities exceeding 4¼ percent.

Representative CURTIS. It has never been your intention, as I understand it, to want to do any discounting on original sales.

Secretary ANDERSON. Yes. We have done, and we will continue to do it whereby so doing we can get finer prices.

Representative CURTIS. Aside from that purely technical feature?

Secretary ANDERSON. Not for the purpose of avoiding the statutory ceiling.

Representative CURTIS. Or for lengthening the debt. That is what I am getting at. You would not be using the discount for that.

Secretary ANDERSON. If we were to sell for cash we would want the limit taken off so that the coupon rate would reflect the true value.

Representative CURTIS. That is right. I am trying to direct your attention to the area where discounting, if that is the proper term—it is even doubtful if it is—would be used in the area of advance refunding. As I understand the position of the Treasury, regarding both

the coupon and the yield, you feel if the full facts were that you were above 4¼ percent, that you would not have authority or should not assume that authority without Congress saying that you have that authority?

Secretary ANDERSON. That is correct.

Representative CURTIS. I think that is quite important.

Now, one other matter. You gave us some figures on the amounts of credit, savings, and where the savings went that occurred over a 10-year period, as I understand it.

Secretary ANDERSON. Two-year period.

Representative CURTIS. I thought it was 10. When you gave us those figures of $4½ billion of Treasury, $35 billion mortgage, $16 billion corporate bonds, $16 billion municipals, was that a 2-year period?

Secretary ANDERSON. The period I referred to was the calendar years 1958 and 1959.

Representative CURTIS. It was a 2-year period, then?

Secretary ANDERSON. Yes. We can get the 10-year figures if you would like to have them.

Representative CURTIS. No, I just misunderstood. I wanted to direct our attention to that period. This was in answer, I believe, to Senator Bush's question about tight money. As I understood in context, the reason you gave those figures was to demonstrate the relatively small part that Treasury issues made up of this composite in the long term.

Secretary ANDERSON. Of the demand against long-term funds.

Representative CURTIS. The demand against.

Secretary ANDERSON. Yes.

Representative CURTIS. Certainly if Treasury was only $4¼ out of over $60 billion, it is a small part, and the interest rate is certainly not set very much by the Treasury. It seems that the market is the dog and the Treasury is the tail.

Secretary ANDERSON. We are the largest single borrower. These figures were pointed out to show that we are not a monopolistic borrower. We go in and compete with others who in the aggregate take many times what we take.

Representative CURTIS. Yes. That was the point. In this picture, too, of course, is the shift possibly from long time money to the short term money which would get us into subjects like consumer credit and other areas where there is a demand. In that market, the Treasury, due to its rapid turnover of the Federal debt, is possibly a bigger factor. Is that true or not?

Secretary ANDERSON. Yes.

Representative CURTIS. In effect, what this interest ceiling is doing is keeping the Treasury out of the long term market, forcing it into the short term market, where the consumer credit, small business groups, farmers, are seeking their money. Is that a correct analysis?

Secretary ANDERSON. If one analyzes the compartmentalization of borrowers, you find normally under 1 year people who borrow to meet payrolls, people who borrow for inventories, for receivables, to borrow to accumulate for their taxes, to maintain charge accounts, revolving credits, buy household durables and that sort of thing.

Representative CURTIS. Did you mention payrolls?

Secretary ANDERSON. That is right.

Representative CURTIS. Business finances payrolls in short term.

Secretary ANDERSON. If one looks at the compartmentalization of 1 to 5 years, you would find working capital, small expansion, automobiles, household durables and this sort of thing. If you look into over 5 years, it is plant construction, equipment, housing, schools; other kinds of facilities. Farmers would fall both in the under and in the 5-year areas. The Federal Government would be in all three to some extent, because of seasonal financing of deficits. What we are doing now is competing primarily in the field where millions of little people borrow their money. We are also enticing out of the mortgage field money from investors who say to themselves why take the long term risk when I can almost get the equivalent for a short term investment which has very little risk in it.

Representative CURTIS. I think it is very important to bring this point out because those who are opposing the removal of the interest ceiling are in effect forcing the Government into the very area where the small people of this country, whom they like to talk about, are going for their funds, and therefore the damage is being directly borne more by them. I would like to turn attention to another area that has not been mentioned but I think is very important, and that is home mortgages. Although they tend to be in the long term field, I know the impact of the fabulous fives on the savings and loan institutions. The fact that money went out of these institutions which finance homebuilding to a large degree and there is a shortage of capital right now in that area. I wonder if you would comment on the home mortgage field.

Incidentally, that is important, too, Mr. Secretary, on the President's Economic Report, although we had a very rosy picture for the future presented to us, a number of the witnesses pointed out that homebuilding was one area where there was a softness.

Secretary ANDERSON. I think several observations might be made, one being that we now have a ceiling. The ceiling on the rate of Government securities has not kept the interest rate on other long types of investment from rising. In fact, they have gone up considerably during the past year and a half, despite the ceiling. I think on the other hand, homebuilding is hurt badly by the ceiling and will be hurt worse because the builders will find it increasingly difficult to obtain construction loans which are short term, normally called interim financing, if the Treasury must continue to borrow all of the Government's huge fiscal requirements simply within the 5 year range.

Secondly, the high short term rates of interest which result at least in part from the Treasury borrowing at the short term acts to pull in long term investment from the mortgage market into short term investments. One might assume that if an individual had $10,000 to invest and can earn 5 percent, or thereabouts, on a security running from 1 to 5 years—or 6 percent on a real estate mortgage—he would be very reluctant to put his investment in a real estate mortgage.

Representative CURTIS. Have you finished, Mr. Secretary?

Secretary ANDERSON. The only other thing I would add is what has been referred to here before. When we issued 5 percent securities, all over the country people went to savings type institutions that are normally suppliers of credit to the mortgage market, withdrew their

funds and purchased the short-term obligations, because they were attractive and because they had been highly publicized.

Representative CURTIS. I have one final question, as to what the effect has been of not having removed the interest ceiling last year when the administration asked for it. Have we saved money in the financing of our Federal debt as the result of this ceiling, or have we actually kept within the ceiling, or is it a fiction?

Secretary ANDERSON. One can never make an absolute statement but I think knowledgeable people in the securities market believe that the sole concentration of the Treasury within the 5 year level has increased interest rates from a quarter to a half percent higher than they would otherwise have been.

Representative CURTIS. Than they would have been if the ceiling were off?

Secretary ANDERSON. Yes. This, of course, can be translated into costs by simply taking the volume of securities which we have had to finance in this field and multiplying out the dollars.

Representative CURTIS. Thank you.

The CHAIRMAN. I have been somewhat alarmed at the tendency of some financial analysts, and this morning of the Treasury, to identify the total amount of investment in these last few years with the money supply. The figure of $60 billion has been brought forward as an indication that money is not tight. Of course, there is duplication in that figure, but the overwhelming proportion consists of savings and investment. The overwhelming opinion of students of finance in the past have been that the funds for investment in industry are derived from savings, reductions in personal income, which are then deposited in savings institutions, and reinvested. I always thought that the aim of getting an investment banking system moving smoothly—at least one of the aims should be that the volume of investment should be equal to the volume of savings, and that savings should not exceed investments in periods of depression and investment should not exceed savings in periods of prosperity, and what is saved should be invested in periods of depression. But the commercial banking system operates on a very different basis, as we all know. Whereas the deposit comes first under investment banking, and the loan comes later and should be limited to the amounts of the deposits, in commercial banking the loan comes first and creates the deposit. It is this function of commercial banking which really creates the money supply. I had always thought that the money supply consisted of cash plus demand deposits. If this is taken as the test, and this has been the overwhelming judgment of financial writers and students, it is under the control of the Federal Reserve system.

The facts are very clear that since 1953 the Federal Reserve has permitted the money supply to grow in demand deposits at approximately the rate of 1.8 percent a year. During this period we have had a retarded rate of growth of 2.3 percent. But even the 1.8 was below the 2.3. This is justified by the reserve on the ground that during this period there was an increase in velocity of circulation. It is not at all certain that our measurements of velocity are accurate. But even if this were so, in my judgment it would largely have been caused by the increase in the interest rates which resulted from

the curtailment in the supply of demand deposits. The increased interest rate diminished bank loans and balances and led to a more rapid turnover of the created deposits and led to more physical turnover of inventories as well. So the increased velocity was a consequence of the increase in interest rates.

I personally think it is a mistake to try to shift this whole question of the money supply away from conventional standards of currency plus demand deposits into this whole field of savings and investments. I hope that this distinction will be borne in mind.

Secretary ANDERSON. Senator Douglas, we are very aware of the distinction. The figures given for the availability or the utilization of long-term credit were not given for the purpose of doing violence to any of the concepts of money, but rather to indicate two things: One, the extent to which credit had been used by the various institutions, and the other, the extent to which it had been made available regardless of the source of the availability. I know that there are differences of judgment and thought about the supply of money as measured in the traditional forms, and it is very difficult to take comparable periods and make comparisons. Because if one takes the period immediately after the war, there was a very large buildup of money because there was nothing for which to spend it. Controls were in being. The velocity was very low. In the years following that time the velocity has become a much more important factor, although measurements are difficult. I think most of us agree now that the reason that the money supply between the years about 1947 to 1949 did not increase much was because of the backlog of money supply left over from the war, plus the fact that velocity was building up. It is very hard to get those figures.

The point that I think we would like to emphasize is that so long as we maintain a high level of business activity in our country, and we want to maintain it in the least inflationary way, we have got to encourage and rely as nearly as we can upon the traditional forms of savings. Not exclusively, but to the extent that we can.

The CHAIRMAN. Congressman Patman has just come in. I know he has been engaged in some very important testimony this morning on a subject somewhat connected with the testimony of the Secretary, and I wonder, Congressman, if you have some questions which you would like to ask.

Representative PATMAN. Mr. Chairman, I know that the Secretary has an engagement at 1 o'clock involving foreign affairs. I certainly want to help him keep that engagement, and I shall not ask any questions. I do want to bring up one point. I wonder, Mr. Secretary, if you will be willing to answer in writing the questions I submit to you.

Secretary ANDERSON. Of course, sir.

(See p. 490.)

Representative PATMAN. I will have to try to make that suffice. It is my misfortune that I was not here earlier. I was testifying before the Ways and Means Committee. I was supposed to be out of there by 11, but I just got out.

If I may take a few moments, I would like to invite your attention to the fact that this committee held some hearings in New York, and we went into the 17 dealers' relationship with the Treasury and the Federal Reserve. We discovered some things that were really

shocking to me. We discovered these 17 dealers that handled so much of the market have a party line telephone. They operate together. They are using a "put and take" system that I thought had been outlawed in every civilized country in the world, including our own. The SEC made it unlawful away back in 1933. I don't know of any organized market such as the stock exchange, either the New York or the American, or any other, that permits put and take transactions. Are you aware of that, Mr. Secretary?

Secretary ANDERSON. I am not aware of any party line. In fact, I have not visited many of those offices. I would assume that with the volume of trading they do, they would all have direct lines to each other.

Representative PATMAN. If I understood the witnesses correctly. They are all hooked up together with direct, private-line telephones. This "put and take," are you familiar with that?

Secretary ANDERSON. I am familiar with the term and the practice to which you refer, but not the practices of these companies sufficiently to comment on it.

Representative PATMAN. Of course, it leads to fixed prices by all of them. I believe one of the witnesses—the one in charge of the Open Market Committee account—admitted in answer to a question that it does lead to identical prices. Is that your understanding?

Secretary ANDERSON. It has been my understanding that they really hit each other's prices, and by so doing generate a competition between them rather than a community of feeling between them.

Representative PATMAN. They don't have any strong competition among themselves, though.

Secretary ANDERSON. Yes, I would certainly say they had competition among themselves. It is very competitive.

Representative PATMAN. You don't have the same understanding of it that I have. If I understand it correctly, they have the same prices. That is the way a "put and take system" works. It means identical prices for those 17 dealers.

Secretary ANDERSON. Congressman, the point, I think, is that if one examines the fluctuations of the market during the day there are fluctuations up and down constantly. If you were going to have a monopolistic system, one would not expect fluctuations in prices and certainly not the wide fluctuation in prices that have taken place in the past several weeks. You would expect a sort of ratchet operation in which prices either moved upward or stayed where they are.

Representative PATMAN. You would not favor the "put and take" system in this particular operation, would you?

Secretary ANDERSON. I would want to know more specifically what the Congressman refers to as put and take.

Representative PATMAN. All right. I will not pursue that further because I can do that in writing. You realize that these 17 dealers do about $200 billion worth of transactions a year.

Secretary ANDERSON. They do about that. I would welcome any number of people who would want to get into the business.

Representative PATMAN. Of course, that is easier said than done, Mr. Secretary.

May I pursue that a little further? The sum of $200 billion a year means about three times the amount of business that is done by all the organized exchanges in the United States—the New York Stock Exchange, American, Midwest, the other stock exchanges and all the commodity exchanges. Is that substantially correct?

Secretary ANDERSON. I do not have the exact figures, but it is very large.

Representative PATMAN. Don't you think a market like that should have some regulations or supervision?

Secretary ANDERSON. As the Congressman knows, we have been looking into the problem of the market operations largely with reference to the avoidance of speculation which occurred in 1958. We are trying to take steps for the improvement of ownership information on Treasury issues. For example, we are sending out letters to 500 corporations who are holders of these securities, to find out more about what kind of securities they have.

One of the most important areas we have to work on is trying to improve the market, and I think we have made substantial progress in the area of information, so that trading in these areas is a matter of public information.

Representative PATMAN. I know, but did you come to the conclusion that you should have some more regulation—or have a regulated market there something like the stock exchange?

Secretary ANDERSON. I have not personally arrived at any conclusion on the question of regulations.

Representative PATMAN. Could you give us the benefit for the record of the information that you have gathered from the different sources?

Secretary ANDERSON. Some of it has been supplied. As information is gathered in the future, we will certainly supply it.

Representative PATMAN. Mr. Randolph Burgess, I think, knew more about the monetary system, interest rates and the national debt than any man I ever knew. When we were questioning him about a free market or not a free market in Government securities, I believe he always used the phrase that he does not claim it is "exactly" a free market. What would you say about the market for Government securities? Would you say it is a free market or not a free market?

Secretary ANDERSON. I am not sure that anybody could ever say that any market is free in the absolute sense. I think that the market for Government securities is one of the most competitive markets in our free economy system.

Representative PATMAN. Wait just a minute, Mr. Secretary. You say it is one of the most competitive markets.

Secretary ANDERSON. I think, when we speak of competitiveness or lack of competitiveness in a market, we have to have some criteria by which to judge. One of those criteria is the alternatives that are open to buyers and sellers. If you look at the alternatives that are open to the lenders of money, they can choose any number of instruments. They can choose whether they are going to put their money into insurance companies or building and loan associations or commercial banks, or whether they are going to buy bonds of corporations or whatever else they are going to buy. The borrowers have a large number of alternatives. The man who wants to borrow money to

build a house can borrow from a commercial bank; he can borrow from a savings and loan association; he can borrow from an insurance company; he can borrow from any other source. The consumers can go to small loan companies. They can borrow on their insurance policies. Business people have the same alternatives. They can go from one bank to another. They can get commercial credit. They can go into the investment market with their securities.

Representative PATMAN. Mr. Secretary, that is very interesting, but they can do the same way in the stock market. They don't have to buy through the New York or American Stock Exchange. They can do everything you are saying.

Secretary ANDERSON. No, but the point I am making, sir—with all of these alternatives, it is difficult for me to see how we can take a Government security, which fluctuates in price and fluctuates very widely, and know that it is in competition with all of the other forms of instruments that can be traded—and say the market is not free and not competitive.

Representative PATMAN. It fluctuates lower in Government securities in the last few years.

Secretary ANDERSON. As I said earlier, it is a competitive market when one looks at these criteria.

Representative PATMAN. I would like to ask you a few other questions. But I will only mention the subjects which I expect to cover in the written questions.

Take the money supply. It has been increasing at about 1 percent, whereas the economy has been increasing about 4 percent. I have a table here that shows the relation of money supply to the gross national product. It started out at 35 percent in 1952 and it is down to 29 percent now, which, of course, I don't like. I feel it is against the public interest.

The Federal Reserve Board has not been carrying out its obligations, the way I understand it; and I am greatly disappointed that the Secretary of the Treasury and the President of the United States have considered them somewhat of a sacred cow and independent and a kind of fourth branch of government, which I think is contrary to the Constitution. I just can't understand how the President and the Secretary of the Treasury can read the Constitution—where it says in article 3, the President shall take care that the laws shall be faithfully executed—and say this Federal Reserve Act is not a law, and let the System go on its own and be a sacred cow, and whatever they do is all right. I just can't understand that. I will ask you some questions about that in writing.

You are spinning your wheels as long as you claim that the Federal Reserve is independent. We have no assurance on the interest rates. Suppose you raise the Treasury rate to 5 or 6 percent? You have no assurance that the Federal Reserve would support you there. In fact, the Federal Reserve has refused to say they would support you at any point. You, in answer to the questions I asked you, stated that you had no agreement with the Federal Reserve, and you did not know whether they would support you or not, which I think is bound to be correct. But I know you have an appointment. So I will not ask any further questions, Mr. Chairman, but I would like to ask those questions in writing and I hope they are answered in time for the transcript—if I get them to him in the next 48 hours.

Secretary ANDERSON. We will answer as rapidly as we possibly can.

The CHAIRMAN. Mr. Secretary, we appreciate your coming. Could I ask for data which show the degree to which changes in the level of interest rates have any effect upon the relative volume of personal saving as a percentage of personal income? That is, do high interest rates increase savings; and if so, to what degree?

Second, what effect do changes in the price level inside the United States have upon personal savings as a percentage of personal income?

Secretary ANDERSON. I am not sure the extent to which we have competent measurements in this field; but to the extent we do have them, I will furnish that information.

The CHAIRMAN. It is a very important question. Twenty-five years ago I went into the question of the effect of interest rates on savings. I could find no relationship between changes in the interest rate and changes in savings, but it may be that later studies may show this.

This concludes the hearings on the 1960 Economic Report of the President. We are required by the Employment Act to file our report by March 1, and we will try to meet that deadline.

We thank you, Mr. Secretary, and your staff.

Secretary ANDERSON. Thank you very much.

(The following was later received for the record:)

QUESTIONS SUBMITTED BY SENATOR DOUGLAS AND REPLIES THERETO

Question 1. What effect do you think changes in the level of interest rates have on the amount of personal savings as a percentage of personal income?

Answer. A similar question was raised in the hearings last summer by Vice Chairman Patman and the Treasury's reply is on pages 3255, 3256 (question 4) in part 10 of the published "Employment, Growth and Price Level Hearings."

Some other points could be added to supplement that answer. In the first place, interest rates tend to be high during prosperous periods when most people are confident of the future. This confidence is expressed in an increased desire to borrow and in an increased desire to spend more freely than in less prosperous times. Increased spending is synonymous with increased prosperity. As a result, there is a powerful tendency for prosperity to encourage spending and discourage saving. This tends to be only partly offset by the tendency for higher interest rates accompanying prosperity to stimulate saving. It is not surprising, therefore, that there is little statistical evidence available as to the effect of changes in interest rates as such on savings since we know of no way of estimating accurately the respective weights of the two factors. It seems reasonable to conclude, however, that there is some marginal influence of higher rates in increasing savings—and lower rates in discouraging savings—given substantially equivalent economic environments.

Another observation should be made. Increases in the interest rate by one type of institution as against another in a specific locality provide ample evidence that savings shift from one form of investment to another when interest rates change. Although many individuals are either unaware or unconcerned about the rate of interest their savings earn, there are many others who pay considerable attention to the rate

of interest. This is most apparent in shifts from one form of saving to another, but it reasonably may be concluded that it has some effect in increasing the overall volume of savings as well.

The problem is further complicated by the difficulty of statistical measurement of the flow of saving. Individuals may save in many ways other than by simply turning a portion of their current income over to financial institutions for investment. They may, for example, save by investing directly in tangible assets, by permitting corporations which they own to retain a share of earnings for investment, by repaying debts, or even by deciding that the various governmental units to which they pay taxes maintain a surplus of receipts over expenditures. All of these methods may directly or indirectly channel funds into capital investment, and changes in the flow of savings through any one will necessarily affect the others.

Question 2. What effect do you think that changes in the level of prices have on personal savings as a percentage of personal income?

Answer. The amount of personal savings depends a great deal more on expectation as to the future trend of prices, rather than the absolute level of prices in any one period of time. The expectation of price stability reflects confidence in the future as far as the purchasing power of the dollar is concerned. On the other hand, uneasiness as to future erosion of the purchasing power of the dollar tends to be accompanied by a reduction in incentives to save, and a greater desire to spend freely and to borrow in the expectation that borrowing can be repaid in cheaper dollars later on. The world's history is full of examples where the economic motivations of all businessmen and consumers were to spend everything on goods and services and save nothing as they responded quite naturally to runaway inflation.

The concept of investment and repayment in fixed dollar claims, which is basic to our free enterprise system, depends greatly on general confidence in the stability of the ultimate purchasing power of the dollar claim. The trend of prices during the past 20 years has been a strong contributing factor to the high interest return currently demanded by investors in debt obligations as compared with equities. As a result, the forms of capital investment which have traditionally been financed through fixed dollar claims have been experiencing difficulties. This trend can only be reversed through strong measures to maintain future price stability.

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C. February 17, 1960.

HON. ROBERT B. ANDERSON,
Secretary of the Treasury,
Washington, D.C.

DEAR MR. SECRETARY: Again, I regret that I was able to attend the hearings of the Joint Economic Committee yesterday only during the last few moments of your appearance. As indicated, I was testifying before the Ways and Means Committee of the House and could not get away earlier.

In accordance with our agreement that I would submit to you in writing the questions I intended to ask you, and that you would answer them promptly for the committee's record, I am attaching my questions herewith.

In order to expedite matters, I have omitted some of the questions I had intended to ask but I believe that the answers to these will serve to resolve the

crucial question whether or not Congress should repeal or modify the legal ceiling on interest rates at which the Treasury can issue long-term securities.

Your cooperation is most appreciated.

Sincerely,

WRIGHT PATMAN.

MARCH 23, 1960.

Hon. WRIGHT PATMAN,
House of Rpresentatives,
Washington, D.C.

DEAR MR. PATMAN: With this letter, I am transmitting to you my replies to the questions which you submitted to me at the close of my oral testimony before the Joint Economic Committee on February 16, 1960.

Two copies are also being transmitted directly to the staff of the Joint Economic Committee.

Sincerely yours,

ROBERT B. ANDERSON,
Secretary of the Treasury.

Question 1

Mr. Secretary, many national magazines have featured your views and arguments for repealing the interest rate ceiling on Treasury bonds. One of these, U.S. News & World Reports, featured an "interview" with you in its issue of August 31, 1959. In the course of this question and answer presentation of your views, you referred several times to the low interest rate policy which prevailed prior to the Federal Reserve-Treasury "accord" of March 4, 1951. According to your description, this policy of maintaining a low interest yield on Government securities, which you call bond "pegging," required the Federal Reserve to buy huge quantities of Government securities from the open market. Further, you argue that these purchases increased the money supply "without specific relation to the demands of the economy" and you quote Mr. Marriner Eccles to the same effect. One question and answer exchange in this interview is as follows:

"Question. Then, did Federal Reserve manipulate the market in order to keep the price of money down?

"Answer. Well, they pegged the interest rate partially because they did not want the interest rate on Government securities to rise—because, if it did rise, the cost of carrying the public debt was greater. Now, the penalty we paid for it was putting additional money into the stream of activities, without specific relation to the demands of the economy, but in order to keep the price of the Government securities level.

"Mr. Eccles, who was Chairman of the Federal Reserve during this period, says this:

" 'The Treasury and the White House, over the strong protest of the Federal Reserve, required this action to be taken. In doing this, an excess amount of bank reserves was created which brought about an inflationary expansion of commercial bank credit and of the money supply. The present administration and the Federal Reserve are trying to avoid making this mistake by curbing the growth of bank credit, and allowing the interest rates to rise.' "

In another place in this interview you say, in support of the recommendation that the 4¼-percent legal ceiling be repealed:

"You cannot avoid realism, and if we want arbitrarily to achieve a lower rate of interest for Government securities, if this is a specific objective, then we would have to resort again to an undesirable alterna-

tive such as Federal Reserve pegging of bond rates, which would be just as hazardous now—more hazardous than it was during the period that Mr. Eccles refers to."

It is understood, of course, that when the Federal Reserve purchases Government securities from the open market, it increases bank reserves by an equal amount. Furthermore, unless the Federal Reserve takes other steps, such as raising reserve requirements of the member banks, newly created bank reserves may result in an expansion of the money supply.

In view of the claims which have been widely made, not just by you, that this is, in fact, what happened in the post-World War II years, I would like to call your attention to the following figures taken from official reports of the Federal Reserve System:

Federal Reserve bank holdings of U.S. Government securities, the money supply expressed as a percentage of current gross national product, and market yields on long-term U.S. bonds

Year	Federal Reserve holdings of U.S. Government securities (end of year)[1]	Money supply as percent of GNP[2]	Market yields on long-term U.S. bonds[3]	Year	Federal Reserve holdings of U.S. Government securities (end of year)[1]	Money supply as percent of GNP[2]	Market yields on long-term U.S. bonds[3]
1945	24.3	(4)	2.37	1953	25.9	34.5	3.16
1946	23.4	50.2	2.19	1954	24.9	35.2	2.70
1947	22.6	46.7	2.25	1955	24.8	33.3	2.94
1948	23.3	42.4	2.44	1956	24.9	32.0	3.11
1949	18.9	42.2	2.31	1957	24.2	30.5	3.47
1950	20.8	39.2	2.32	1958	26.3	30.9	3.43
1951	23.8	35.6	2.57	1959	26.8	29.3	[5] 4.07
1952	24.7	35.5	2.68				

[1] Source: Annual Report of Board of Governors of the Federal Reserve System, 1958; and, for the year 1959; Federal Reserve Bulletin, January 1960.
[2] Source: Computed from data reported in Federal Reserve Bulletins. ("Money supply" data are 13-month averages of demand deposits, "adjusted," plus currency in circulation outside of banks.)
[3] Source: Federal Reserve bulletins.
[4] Not available.
[5] Average for 1st 9 months only.

You may notice that the Federal Reserve holdings of U.S. Government securities was *not* increased in the post-World War II years. On the contrary, between the end of 1945 and the end of 1950—just 2 months before the accord of March 4—the Federal Reserve's holdings of these securities was reduced by $3.5 billion.

You may also notice that the money supply which you have referred to (demand deposits in the commercial banks plus currency in circulation) was reduced relative to the gross national product in these years, not increased. Specifically, the money supply was reduced from 50 percent of the gross national product in 1946 to 39 percent of the gross national product in 1950.

Since the factual record makes it appear that you have read history upside down, I would appreciate a clarification of your statement, by way of answers to the following questions:

(*a*) Since the Federal Reserve made a substantial reduction in its holding of Government securities in the postwar years, and made a substantial reduction in the money supply as it is normally measured, do you consider that there is a more significant way of measuring the

Federal Reserve's contribution to credit in this period; and, if so, what is it?

(*b*) Since yields on long-term U.S. bonds were still maintained at an average of $2.57 percent for the year 1951—despite the "freeing" of interest rates on March 4, 1951, is it fair to conclude that the difference between what you believe was an "artifically low" rate of 2.32 percent in 1950 and what you believe was the "free market" rate was only one-quarter of 1 percent?

Answer 1 (a)

There is no single method for measuring, in any given time period, the "adequacy" of Federal Reserve contribution to credit and, more importantly, to monetary growth. Measures that are appropriate for one period of time may, because of changes in basic economic factors, be unsuitable for another period. Inasmuch as the period 1945–50 holds many important lessons for monetary policy and debt management, it is especially important that any evaluation of events in the period be based upon a careful study of all—not just a few—of the significant factors.

In measuring the contribution of the Federal Reserve to commercial bank lending ability (which can be viewed as its "contribution to credit"), there are a number of measurements that are much more significant than the change in Federal Reserve holdings of Government securities. Perhaps most useful in this respect is the change in member bank reserve balances, after making appropriate allowance for changes in percentage reserve requirements. Thus we find that, between the end of 1945 and the end of 1950, the decline in System holdings of Governments was *more than offset* by the net change in other reserve factors, principally a $2.6 billion increase in the Nation's gold stock. As a consequence, member bank reserve balances actually rose from $15.9 billion to $17.7 billion, an increase of $1.8 billion, or 11 percent. Moreover, the increase in reserve balances understates the impact on bank lending ability, inasmuch as member bank reserve requirements, on average, were somewhat lower at the end of 1950 than at the end of 1945.

It is apparent, therefore, that reference solely to changes in System holdings of Government obligations in the 5-year period can be misleading. If a broader view is taken, it is seen that the *net* of System operations and other factors affecting member bank reserves was to contribute significantly to the lending ability of the banking system during a period that, on balance, was dominated by strong inflationary pressures.

While trends in member bank reserve balances provide an important measure of Federal Reserve contribution to bank lending ability, the rate of money growth, relative to the state of the economy, is an even more significant measure of the impact of monetary policy. In this respect, we find that, between the end of 1945 and the end of 1950, the money supply as usually defined (currency outside banks plus adjusted demand deposits) increased by more than $15 billion. This increase, which represents monetary growth at an annual rate of 2.8 percent during the period, was surely more than ample in view of the fact that the money supply had risen to an abnormally high level at the end of 1945, and the turnover (or velocity) of the money supply was at an alltime low for modern times.

Reference is made in the question to "a substantial reduction in the money supply as it is normally measured * * *." Inasmuch as the money supply as usually defined rose by more than $15 billion during the period, reference must be assumed to be to the ratio of money supply to gross national product (GNP), which declined from 48 percent at the end of 1945 to 41 percent at the end of 1950. Viewed in reverse, GNP was 2.09 times the money supply in December 1945 and 2.42 times in December 1950. These last measurements are often referred to as the "income velocity" of the money supply.

The phrasing of the question implies that the "adequacy" of the money supply can be measured in terms of its relationship to the *dollar value* of GNP. According to this criterion, presumably the goal of monetary policy would be to maintain some constant ratio between the two. The adoption of such a guide to monetary policy would be highly dangerous; indeed, such an arrangement would embody the potential of a cumulative, self-feeding increase in the price level during periods of rising demand for goods and services, and a cumulative decline in prices, output, and employment during recessions.

The ratio of money supply to GNP tends to decline (income velocity tends to rise) during a business recovery. Following the rule of attempting to maintain a fixed ratio between money supply and GNP, the monetary authorities under these conditions would be expected to step up the rate of monetary growth, in order to restore the "adequacy" of money supply relative to GNP. But this would tend to foster further increases in demand for goods and services, and GNP might rise further relative to money supply. At some stage, prices would begin to increase, the dollar value of GNP would rise even further, more money would have to be created to remove the "deficiency" of money supply, and so on. An upward spiral of inflation would be the likely result, and the process might come to a halt only as the consequence of a crisis and severe reaction. The process here described is, of course, identical with those of several great monetary inflations in other countries in the past, in which attempts to keep the money supply "adequate" relative to the "needs of trade" resulted in a faster and faster rise in prices and the velocity of money.

Conversely, the ratio of money supply to the dollar value of GNP tends to rise during a recession. If the monetary authorities were to attempt to maintain a constant ratio between money supply and GNP, the money supply at such times would have to be *reduced* in absolute terms. Such reductions would, of course, contribute to a steeper decline in GNP and employment, the "excess" of money would grow even larger, the money supply would have to be reduced further, and so on. Obviously, such actions would be the reverse of those actually required of a flexible and responsible monetary policy and, in the event of strong recessionary forces, would probably lead to severe economic depression.

With respect to the period 1945–50, it is noteworthy that at the end of the period the income velocity of money (the inverse of the ratio of money supply to GNP) was still slightly lower than in the abnormal depression years of the 1930's, and still much lower than in the prosperous years of the 1920's. These considerations, coupled with

the fact that prices rose considerably, lend strong support to the judgment that the rate of monetary growth was actually excessive, rather than deficient, during the 5-year period.

In conclusion, it is well to repeat that neither the flavor nor the impact of monetary actions in a given period can be judged solely in terms of one measurement. Although Federal Reserve holdings of Government securities did indeed decline between the end of 1945 and the end of 1950, this decline was more than offset by changes in other factors influencing member bank reserves, the most important of which was a $2.6 billion increase in the Nation's gold stock. The fact remains that the policy of supporting the prices of Government securities at relatively high levels led to considerable monetary growth, despite the fact that the money supply was clearly excessive at the end of 1945. If it had not been for the fact that Federal cash receipts from the public exceeded cash payments by almost $13 billion during the period (which explains in part the decline in Federal Reserve holdings of Government securities, as part of the surpluses was used to retire securities held by the Reserve banks), inflationary pressures would have been much greater than was actually the case.

Answer 1 (b)

The yield of 2.57 percent is actually an average for the year 1951 as a whole, and thus includes more than 2 months in which yields on long-term bonds continued to be pegged at a maximum of 2.50 percent. Yields on long-term Government bonds averaged 2.62 percent in the 9 months of the year following the Treasury-Federal Reserve accord, in which the yields were permitted to seek their own levels, and the average yield on the bonds at yearend was 2.70 percent. Thus the difference in yields before and after the freeing of interest rates was somewhat more than one-fourth of 1 percent.

Even with the spread thus corrected, however, these figures only in part reflect the difference in free market versus artificial determination of long-term interest rates. One important factor holding the spread to this amount was the various restraints on private borrowing and spending during the Korean conflict, which helped dampen private demand for funds in 1951 and stimulated personal saving. Of perhaps even greater importance as a factor in holding down interest rates during the period was a Federal Government budgetary surplus of $3.5 billion and a cash surplus of $7.6 billion in fiscal year 1951. The large reduction in the publicly held debt made possible by the cash surplus was an important factor in supplying funds to credit markets and thus reducing the pressures for higher interest rates following the accord.

Question 2

In its annual report for 1951, the Board of Governors describes what it considered to be "inflationary pressures in the private sector of the economy" proceeding "at an unusually rapid rate" only after the beginning of 1951. This report goes on to describe the "accord," the actions taken immediately thereafter, and then it makes this statement:

"The new market situation contrasted sharply with the situation that had prevailed throughout the postwar period, when any amount of bonds could be sold readily at relatively fixed prices."

My question is, first, whether you agree that throughout the postwar period, up until the beginning of 1951, any amount of bonds could be sold readily at relatively fixed prices? And, second, if you do agree, what distinguishes the present situation which makes it impossible to sell any amount of bonds at the relatively fixed prices prevailing in the postwar years?

Answer

During much of the postwar period, up until the time of the Treasury-Federal Reserve accord in March 1951, a large amount of Government bonds were sold readily by investors to the Federal Reserve at relatively fixed prices. Since that time, however, the Federal Reserve authorities have properly pursued a flexible monetary policy, which can be effective only when interest rates and prices of Government bonds and other debt securities are free to reflect the impact of demand and supply factors in credit markets. If the Federal Reserve stood ready today to purchase large amounts of publicly held Treasury securities at the relatively high prices (low interest rates) that prevailed during World War II and until 1951—or even at somewhat higher rates—the stage would be set for a rapid and highly inflationary increase in the money supply as holders of Government securities sold them to the Federal Reserve in exchange for high-powered dollars.

In brief, the distinction to be drawn is between (1) a market in which prices of Government securities are "pegged," through Federal Reserve offers to purchase, and (2) a market in which prices of such securities are permitted to respond to the forces of demand and supply, including the impact of flexible monetary policies.

Question 3

With reference to the credit expansion which the Federal Reserve allowed to take place between the outbreak of the Korean hostilities and the accord of March 4, 1951, I would like to call your attention to a statement made by Mr. Allan Sproul before a subcommittee of the Joint Economic Committee in March of 1952. Mr. Sproul was, of course, at the time president of the Federal Reserve Bank of New York, a member of the Federal Open Market Committee, and, I believe, a rather dominant figure in the Federal Reserve System. Mr. Sproul said:

"From July 1950 to February 1951, the System's holding of securities increased $3.9 billion.

"There were additional gains in an increase through member bank borrowings and other factors. There was an offset through an outgo of $2,100 million of gold and required reserves were increased in February and January 1951 by $2 billion, leaving an increase in free reserves of $1,100 million.

"Of this amount $100 million was added to excess reserves, and $1 billion was used as the basis for credit expansion. The growth in total loans of commercial banks during the period amounted to a

little less than $9 billion, and in the same period investments of commercial banks were reduced by about $5½ billion. The money supply increased by $5 billion, or a little less than 5 percent as compared with the rise of 17 percent in the whole commodity price index. It does not justify the conclusion that the growth in the money supply and bank credit was of no consequence, however."

Now if Mr. Sproul's statement was correct, several observations can be made: First, the $4 billion increase in the Federal Reserve's holdings of Government securities between July 1950 and the end of February 1951 still brought the Fed's total holdings to a level below that of 1945, 1946, 1947, and 1948; and this $4 billion increase was, in fact, less than the $4.4 billion reduction which the Federal Reserve had made in its holdings between 1948 and 1949.

Second, only a small fraction of the $4 billion of Government securities acquired after the outbreak of the Korean hostilities and just prior to the accord was allowed to be reflected in increased bank credit. In fact, the $4 billion increase in bank reserves which this acquisition would have brought about was more than offset by $2.1 billion outflow of gold and by a $2 billion increase in reserve requirements in January and February 1951. At the same time, however, the Federal Reserve increased loans to member banks and permitted a 5-percent increase in the money supply.

Now my questions are these:

(a) Is it reasonable to conclude that the Federal Reserve permitted a 5-percent increase in the money supply, in this period of rapidly advancing economic activity, only because it thought this an appropriate amount of credit to be added to the system at this time?

(b) Do you consider that bank profits were at a satisfactory level at this time?

(c) Do you feel that had the Federal Reserve System further raised reserve requirements of the member banks so as to prevent any increase in the money supply at this time, assuming that it would have preferred to permit no increase in the money supply, an undue portion of the burden of meeting the national emergency would have been placed upon bank profits?

Answer 3(a)

Statements by Federal Reserve authorities have made it clear that they believed the rate of monetary growth in the latter part of 1950 and early 1951 to be excessive. Indeed, this high rate of monetary growth, coupled with the probability that a relatively high rate would continue in the future if the Federal Reserve continued to peg prices of Government bonds, was a major factor leading to the Treasury-Federal Reserve accord of March 1951.

Answer 3(b)

As is shown in the table, in 1950 net profits of commercial banks that were members of the Federal Reserve System were 8.3 percent of total capital accounts. This ratio declined to 7.6 percent in 1951, the year in which any additional increases in reserve requirements (beyond those effected in January-February 1951) would have had their primary impact on bank earnings.

All member bank profits and capital accounts

	Net profits after taxes	Average total capital accounts	Ratio net profits to average total capital accounts [1]		Net profits after taxes	Average total capital accounts	Ratio net profits to average total capital accounts [1]
	Millions	*Millions*	*Percent*		*Millions*	*Millions*	*Percent*
1940	$349	$5,597	6.2	1950	$781	$9,455	8.3
1941	390	5,798	6.7	1951	756	9,947	7.6
1942	383	5,977	6.4	1952	829	10,480	7.9
1943	557	6,304	8.8	1953	865	11,043	7.8
1944	649	6,712	9.7	1954	1,096	11,724	9.3
1945	788	7,243	10.9	1955	985	12,499	7.9
1946	758	7,868	9.6	1956	1,027	13,270	7.7
1947	653	8,291	7.9	1957	1,169	14,108	8.3
1948	621	8,630	7.2	1958	1,457	15,086	9.7
1949	686	8,999	7.6	1959	1,252	15,905	7.9

[1] Ratios for 1940 through 1947 not entirely comparable with subsequent years due to transfers to reserves for bad debt losses on loans beginning in 1948.

Source: Office of the Secretary of the Treasury.

Reasonable men might disagree as to whether this level of member bank profits, as related to capital, was or was not "satisfactory." However, in view of the need to strengthen bank capital positions, coupled with the fact that net profits to capital accounts in 1951 were the second lowest since 1942, it would not appear that member bank profits were unduly high in 1951.

Answer 3(c)

In my opinion, further increases in member bank reserve requirements in early 1951 would have been a relatively ineffective and undesirable substitute for elimination of the pegging program for several reasons.

In the first place, the increases effective in January and February 1951 brought reserve requirements against net demand deposits for reserve city and country member banks to their statutory maximums (20 and 14 percent, respectively) and for central reserve city banks to within 2 points of the maximum (to 24 percent, as compared with a maximum of 26 percent). The requirement behind time deposits for all classes of member banks was also raised to the maximum (6 percent). Consequently, unless Congress had enacted new legislation raising the legal maximums, the Board of Governors could have raised requirements, after the January-February 1951 increases, only with respect to central reserve city banks, and the maximum increase in this case would have absorbed only $500 million in reserves. From the standpoint of legal authority, therefore, it is clear that the Board of Governors went almost to the limit in increasing reserve requirements to reduce the inflationary impact of the pegging operations.

Secondly, there is considerable question as to how effective additional increases in reserve requirements would have been, if held to reasonable limits; indeed, it is doubtful that the increases in January–February 1951 had much of a restrictive effect. This is because member banks at the beginning of 1951 still held $52 billion of Government securities and, in view of the Federal Reserve pegging policy, could easily liquidate securities to obtain the additional reserves needed to meet the higher requirements. Indeed, a substantial portion

of System purchases in January–February 1951 probably resulted directly from the increase in reserve requirements, as the Federal Reserve acquired securities liquidated by member banks to meet the increase in requirements. This is not to say that the increases in reserve requirements had no restrictive effect, but only that the effect was greatly diminished by the simultaneous System purchases of securities under the pegging program.

Finally, there is considerable doubt in my mind as to the appropriateness of a monetary policy involving directly contradictory utilization of two important instruments of credit control. If monetary policy is to serve its proper function in contributing to sustainable economic growth, it must be administered flexibly, not only with respect to the overall direction of policy at different stages of the business cycle, but also in regard to the flexible use of each of the credit control instruments. The use of open market purchases to support the prices of Government bonds at relatively high levels, coupled with increases in reserve requirements to nullify the reserve-creating effect of the purchases, could only hamper the effective administration of flexible monetary policy.

Question 4

Referring back to the table under question 1, I call your attention to the fact that since 1946 the Federal Reserve has reduced the money supply relative to the gross national product each year, with minor exceptions in 1954 and 1958. Whereas the total money and credit in the banking system amounted to 50 percent of the current gross national product in 1946, it had been reduced to 29 percent of the gross national product in 1959. Furthermore, the rise in interest rate yields on long-term U.S. bonds has paralleled this reduction in the money supply. My questions are these:

(*a*) Has the rise in Government bond yields been caused mainly by the tightening of the money supply?

(*b*) Since 1952 has the rate at which the money supply has increased been at all times the product of conscious and deliberate decision by the Federal Reserve authorities?

Answer 4(a)

No. Yields on long-term Government and other securities are in the long run determined primarily by the demand for long-term credit relative to the available supply of savings that are committed to the long-term market. Inasmuch as changes in the money supply reflect primarily the activities of commercial banks in extending credit, changes in the rate of monetary growth may influence short-term interest rates considerably, but it is doubtful that such changes have any long-lasting effects on long-term rates. The sharp changes in long-term rates at the time monetary policy shifts toward ease to combat a recession or back toward restriction in recovery arise primarily from expectational effects and speculation, rather than changes in the basic determinants of long-term interest rates. Any such changes stemming from shifts in expectations are likely to be short-lived, unless the expectations are in fact ratified over time.

The primary factor underlying the rise in Government bond yields since the end of the Second World War has been the tremendous

increase in credit demands, pressing against a limited supply of savings. From the end of 1946 to the end of 1959, total public and private debt rose from $446 billion to $938 billion, an increase of $492 billion, or more than 100 percent. Although the supply of savings has increased considerably, it has not kept pace with this huge increase in demand. The inevitable result has been a marked increase in the price of borrowed money, or interest rates.

One other point should be mentioned. The fact that the ratio of money supply to gross national product has declined as interest rates have risen does not prove that the relative change in the money supply has *caused* the increase in interest rates. Both are symptoms of a situation in which credit demands press strongly against the available supply of savings.

It may be true that, under such circumstances, a faster rate of monetary growth might temporarily arrest the upward trend in interest rates. Any such interruption is likely to be temporary, however, because the additional money injected into the economy will tend to promote higher prices for goods and services. Once this occurs, interest rates will tend to return to their earlier levels, and perhaps rise to even higher levels as many investors who are fearful of inflation become reluctant to commit their funds for long periods of time, and borrowers who expect inflation become more willing to incur debt.

Money creation beyond the requirements of sustainable economic growth, therefore, cannot be viewed as a permanent solution to the problem of high interest rates. It is at best a palliative which, in the long run, leads to inflation and even higher levels of interest rates than would otherwise prevail.

Answer 4(b)

Although I cannot, of course, speak for the Federal Reserve, it is my understanding that the monetary authorities do not attempt to achieve any predetermined rate of monetary growth. Thus, in my judgment, it would be a mistake to conclude that the rate of growth in the money supply since 1952 has been "at all times the product of conscious and deliberate decisions by the Federal Reserve authorities."

Question 5

It is frequently said that the decision that the Federal Reserve would cease maintaining a publicly announced maximum rate on U.S. Government securities was reached with the so-called Treasury-Federal Reserve accord of March 4, 1951. In contrast, however, I believe in his appearance before a subcommittee of the Joint Economic Committee in March 1952, the year following the accord, Mr. Allen Sproul dated the decision as August 18, 1950. Speaking of the events leading up to the accord, Mr. Sproul said:

"But when we came to August 18, 1950, when the situation seemed to us to be so clear that there could be very little reason for doubt, we then did take action. It was not in March 1951, it was in August 1950, when we decided to go our way, despite what the Treasury had done with respect to the terms of its financing, and took the risks involved in that decision."

In other words, if I understood Mr. Sproul correctly, it was not in March 1951 that a mutual decision was reached, but rather on Au-

gust 18, 1950, that the Federal Reserve authorities made a unilateral decision that they would go their own way, despite all previous agreements with the Treasury and all previous understandings with the President notwithstanding.

Now as to the exact meaning of the accord, how it came about, and precisely what was agreed to, I believe that the public and the Congress may have only a one-sided picture, and that from only one of the parties to the agreement, namely the Federal Reserve. The public documents consist, I think, only of the following: During our hearings in 1952, the Federal Reserve Board and the Secretary of the Treasury, Secretary Snyder, submitted identical statements describing the accord. Furthermore, this was the Board's statement in reality, it appears, because it is presented as the Board's statement in the Annual Report of the Board of Governors for 1951. Then, of course, if my memory serves me correctly, Secretary Snyder was not personally a participant in the "accord" negotiations, but was in the hospital with a serious illness at the time.

My questions are these:

(*a*) Whether you would object to having the files of the Treasury searched and then sending up to the committee for its inspetcion any memorandums, minutes, or other documents you may find pertaining to the events and negotiations leading up to the accord and to the meaning or interpretations of the agreement reached in the accord.

(*b*) Similarly, as you will recall, after maintaining for several years a rate of 0.375 percent on 91-day Treasury bills, the Federal Reserve authorities decided, in July 1947, to go their own way with respect to the rate on these securities and approximately doubled the rate within a month—a decision which was generally understood at the time to be President Truman's reason for appointing a new Chairman of the Federal Reserve Board to replace Mr. Marriner Eccles.

I wonder if you would object to having the files of the Treasury searched and then sending up to the committee for its inspection any documents you may find pertaining to any negotiations that Treasury officials may have had with the Federal Reserve authorities concerning this decision or any advices or notices that the Federal Reserve authorities were gong to take this action.

In making these two requests of you, please be assured that my purpose is not idle delving into history nor even to try to correct the misstatements of history being so widely made these days. Manifestly, the only alternative which the country has today to the Federal Reserve's policy of maintaining high interest rates is a Federal Reserve policy of maintaining low interest rates, or a policy of maintaining something in between. Consequently, I believe that the Congress and the public have a right to know, and should know, what the practical advantages and disadvantages of the two policies are, and thus we should know what our practical experience with the low interest rate policy was, as well as the reasons for abandoning the low interest policy in favor of the high interest policy.

In other words, the real issue Congress must resolve is not the semantics in which the issue is frequently put, not whether the Federal Reserve's previous policy of maintaining low interest rates was an "artificial interference" in the market, or whether its policy of

maintaining high interest rates is "freeing the market to the natural forces of supply and demand." Interest rates have not been freed, but rather the people who determine interest rates have been freed to pursue their preferences for high interest rates.

While I do not doubt that you sincerely believe that Congress has no proper choice, that the only right course of action for it to take is to repeal the legal ceiling and thus permit the Federal Reserve to make interest rates as high as it sees fit, I believe with equal sincerity that Congress should consider the relative advantages of both the high interest policy and the low interest policy, and should thus have all of the information which can be made available about both policies. Now to other subjects.

Answer

As you know, I was not personally associated with any official policy decisions of either the Treasury or the Federal Reserve System during the period prior to the Treasury-Federal Reserve accord in March 1951. Nor have I any personal acquaintance of the discussions which led up to these decisions. I have asked my staff, however, to review these events carefully and to examine any material available in the Treasury Department's files which might help to answer the questions which you raise.

I have been reminded that the Treasury-Federal Reserve accord in March 1951 represented principally an agrement by the two agencies to, in essence, free the intermediate and longer term Government bond market from arbitrary support operations so that prices of outstanding bonds could seek their own levels in a competitive market, so that the Federal Reserve could better control excessive credit expansion in the post-Korean attack environment of heavy inflationary pressures. It is my understanding that this was a mutual decision. There was also agreement between the two agencies on many earlier occasions, including the decisions involved (despite some difference of opinion as to timing) in the gradual movement to free the short-term Government securities market from Federal Reserve support during the 1947–50 period.

It is my understanding further that the two decisions on August 18, 1950—by the Treasury to offer new 13-month notes priced on the market as of the time of announcement, and by the Federal Reserve to increase the discount rate to help stem credit excesses—are correctly interpreted as an expression of sincere but serious differences of opinion between the two agencies as to the role of the Federal Reserve System in relation to inflation control and to Government financing at a time where there was great uneasiness as to the possibility that the Korean conflict might evolve into an even more serious national emergency.

I have been assured that our records indicate that the Treasury's point of view on the events leading up to the accord was most carefully and exhaustively presented in 1952 in response to question No. 17 submitted to the Secretary of the Treasury by the subcommittee of the Joint Economic Committee dealing with monetary policy and management of the public debt—a subcommittee of which you were chairman. Question No. 17 was phrased as follows:

"Describe fully the issues involved in policy discussions between the Treasury and the Federal Reserve System from the end of the

war until the accord announced by these agencies on March 4, 1951. What were the areas of agreement and the areas of disagreement and how did they change over time during this period?"

Secretary Snyder's reply to this question covers the period in detail, running from page 50 through page 74 of part I of the committee's publication relating to that inquiry. It is my understanding that this reply represented a critical and independent presentation by the Treasury of its position. A review of our files in response to your current request fully supports this conclusion.

I have also been assured by the Treasury staff that the answer to your question No. 18, "Describe the nature of the accord between the Treasury and the Federal Reserve System which was announced by them on March 4, 1951," was truly a jointly prepared answer, and is not correctly construed as a response reflecting only the Federal Reserve's point of view.

I believe you will also find after a careful rereading of the Treasury reply to this question No. 17 that it is responsive to your current inquiry as to the circumstances surrounding the Federal Reserve decision in July 1947 to free the Treasury bill rate from its wartime pegged levels (see pp. 61–62 of the Treasury's answers to your questions at the time). I refer you particularly to the following paragraph on page 62:

"There was some difference of opinion between the Treasury and the Federal Reserve as to the timing of the interest rate actions and the rapidity with which they should be put into effect. Despite these differences in emphasis, the Treasury and the Federal Reserve did move together in the direction of higher rates in this period. The bill rate was allowed to move up starting in July 1947. The 1-year certificate rate was raised from the seven-eighths-percent wartime rate which still existed in 1947 to 1¼ percent by the fall of 1948, by means of a series of certificate and short note issues which accomplished the change in a gradual way."

I appreciate your assurances that your purpose in asking these questions is not idle delving into history. I cannot, however, agree with you that Federal Reserve monetary policy is properly characterized as a "high interest rate" policy. As I mentioned in my replies to your earlier questions, Federal Reserve monetary policy in recent years is, in my opinion, appropriately described as a flexible policy which permits the forces of supply and demand to operate on a competitive basis in the credit markets of the country. Interest rates are typically higher during periods of rising business activity than when business is declining. This reflects the tremendous pressure of heavy demands for borrowed funds as businessmen, homeowners, and State and local governments translate their confidence in the future into demands on the money market. All of these demands cannot be met, even if it is assumed that all of the purposes of borrowing are desirable. This is simply true because the volume of available savings tends to grow much more slowly than the demand for funds, and to meet the gap between the two through bank credit expansion in excess of sustainable rates of economic growth is to invite a further erosion in the purchasing power of the dollar. The flexibility of monetary policy is readily discernible as it responds to changes in our economic environment. I do not believe that a

policy which results in interest rates on short-term Treasury bills as low as five-eighths of 1 percent—as occurred less than 2 years ago—can be appropriately described as a "high interest rate policy."

Question 6

With reference to the questions which I handed you when you appeared before the committee last July, and which you finally answered in December, several of these are incompletely answered, or were perhaps misunderstood. Consequently, I would appreciate it if you would expand on your answers to the following:

In your answer to my question No. 1 of last summer, you have said that the "*level of yields on Treasury securities*, and on other securities as well, is established through the market force working through the demand for and the supply of credit."

At another place I posed quite similar questions to both you and Chairman Martin concerning the rate of savings. Specifically, the question I posed to you was:

"(4) Do you have any evidence that people have saved any larger percentages of their incomes when interest rates were high than when interest rates were low?"

Chairman Martin gave his evidence on this subject (p. 3356 of the committee's hearings, pt. 10) which shows that the rate of personal savings has been rather constant over the past 10 years, although the highest rate of savings occurred in 1952, 1953, and 1956—all years of relatively low interest rates.

Your answer to the question assures us that "an adequate flow of saving is an essential requisite if our economy is to remain strong and realize its full growth potential." And it otherwise indicates that you strongly hold a theory that high interest causes people to save more, but it neglects to answer the question whether or not you have any factual evidence on the subject. So I would like to restate my question in two parts as follows:

(*a*) If you have made any analysis which shows any correlation at all between the level of interest rates available to savers and the percentage of their incomes which the American people have saved, please be good enough to share your analysis with the committee.

(*b*) With reference to the last 10 years, which includes years when interest rates have been low, as well as years when interest rates have been abnormally high, does the factual evidence show that the total demand for investment funds—including the funds needed to meet the net current deficits of the Federal, State, and local governments—has been a greater percentage of the national income in years when interest rates were high than in years when interest rates were low? (Please supplement your answer with the evidence.)

Here again, please be assured that I am not challenging your theories without some basis for thinking these theories may be erroneously held, though sincerely held.

For example, the Ford Foundation, which is held by Mr. John J. McCloy, chairman of the Chase Manhattan Bank, made a report in June of last year titled "The Wealth of a Nation." One chapter, titled "Why People Save," reports, in part, as follows:

"Why do people save? Researchers asked this and a variety of other questions in their interviews. Their interim report shows that people save for several reasons: nearly everyone to provide for their

old age, more than half for unexpected emergencies, and relatively few to pay off debts.

	"Percent of savings unit
To provide for old age	98
For emergencies or a rainy day	60
For children's education	44
To leave an inheritance to children	29
To buy some particular item—a car, furniture, etc	18
For a trip or vacation	17
To buy or build a house	17
To pay off debts	14
No particular reason	2"

In other words, it appears that of all the people asked why they save, one one said that he saves because of the interest he can obtain on his money.

Answer

As I pointed out in the answer to questions you submitted to me last summer, the flow of personal savings is dependent upon the voluntary decisions of millions of individuals. The willingness of individuals to save is, of course, continuously influenced by a great many factors, only one of which is the expected interest return. Among these factors are current and anticipated levels of income, alternative uses of funds, and some assurance that the purchasing power of the dollars saved will be reasonably maintained.

There are, I believe, two fundamental reasons why it is extremely difficult to draw valid conclusions as to a precise relationship between interest rates and the amounts of saving. One of these reasons has to do with the nature of the saving process itself and the way in which funds flow through our economy. The other relates to problems of definition with respect to saving statistics themselves.

It is obvious in the first place that in any free market economy interest rates tend to be higher during prosperous periods. These are periods when most people are confident of the future. This confidence is expressed in an increased desire to borrow and, concurrently, in an increased desire to spend more freely than in less prosperous times. Increased spending is synonymous with prosperity. As a result, there are powerful forces in such periods that encourage spending, and, conversely, discourage saving. It might be expected, therefore, that if statistical measures were accurate—and if everything else were equal—the amount of saving during prosperous times would be less than in periods of depression.

The fact that interest rates are higher during prosperity than in depression, however, helps to offset this tendency toward greater spending and lesser saving, since higher rates help sharpen the incentive to meet the goals for which individuals wish to save—a new home, a college education for their children, or a retirement income. There is no way, of course, of estimating statistically how these two ingredients affect the level of saving. It is nevertheless logical to conclude that there is some significant marginal influence of higher interest rates in stimulating saving—and lower interest rates in discouraging saving—given substantially the same economic environments.

Any historical analysis of saving must be interpreted in the light of this association of higher rates with prosperous conditions during

periods when free market prices are dominant. During the depression saving was low, interest rates were low and incomes were low. These factors, however, reflected the same basic characteristics of the economy at the time—a lack of confidence in the future. Bank credit was readily available, but few qualified people wanted to use it because they weren't sure enough of their future income prospects to want to borrow, even at very low rates of interest. Lenders were also hesitant to advance funds because of uncertainty as to the borrower's prospects. The rate of saving was low because economic activity, employment and incomes were at such a low ebb that there was very little income left over in the hands of the average family after meeting the necessities of life.

During World War II, on the other hand, rates of saving were very high. This is not surprising even though interest rates remained low. Interest rates remained low only as a result of Federal Reserve support of the Government securities market, which was quite feasible at the time because such support was accompanied by strict wartime controls on prices, wages, and allocations of materials to prevent demands for funds from being translated into borrowing requirements or into higher interest rates. In effect, people were being forced to save since their spending was curtailed.

Following the war the rate of saving fell dramatically as a free economy was gradually restored. Personal saving, as a percentage of disposable personal income in the 5 calendar years 1946–50 averaged only 5½ percent—which is a lower average than for any single year since the Federal Reserve-Treasury accord in March 1951, when longer term interest rates were freed to move with market forces.

The use of these figures on personal savings and personal disposable income as defined by the Department of Commerce leads to my second observation which relates to important qualifications as to the adequacy of statistics either to prove or disprove relationships between rates of saving and interest rates.

As you are well aware, there are a number of different concepts of saving. You have asked for my comments on two of them. The first relates to saving by individuals, and the second to one of the many concepts relating to the overall demand for investment funds. I will approach the problem of statistical measurement of individual saving first.

As already suggested, the most generally used concept of measurement of individual saving is the personal saving concept developed by the National Income Division of the Department of Commerce. Our progress in the field of economic statistics has been truly outstanding and our data in the national income field are unequaled anywhere in the world. The Commerce estimates are very carefully prepared and are properly held in high regard. Yet we all recognize that the definition of saving used in these basic statistics is a residual concept in that after deriving estimates of personal income (including various forms of imputed income as well as money income), both taxes and the expenditures (actual and imputed) of individuals for all types of goods and services—including consumer durables such as automobiles and appliances—are subtracted. It is obvious that

there may be a significant margin of statistical error in any residual figure derived in this way because of the difficulty of estimating many of the components of both aggregates. For example, data on the net income of nonfarm entrepreneurs must necessarily be largely on an estimated basis. Current data on the income in service industries, and on rent and interest payments must also be largely estimated. Data are reasonably complete on many phases of individual spending, but there are many categories, such as expenditures for domestic help and other services, which can only be broadly approximated. Regardless of the care with which these estimates are made, the analysts who put them together are faced with much the same problem with reference to current data as we are in the Treasury in working out budget estimates for the period ahead. A small error in estimating Federal expenditures and a small error in the opposite direction in estimating receipts can very easily double or halve an estimate of budget deficit or surplus.

The same observation can be made in the field of national income statistics. Personal disposable income after taxes last year is estimated currently at $334½ billion. Personal consumption expenditures are estimated at $311½ billion. The difference is $23 billion of personal saving, calculated residually. Let us assume that later revisions indicate that personal disposable income was understated by 2 percent, and that personal consumption expenditures were overstated by 2 percent. The figures would then show $341 billion of disposable personal income and $305 billion of personal consumption expenditures, with a personal savings residual of $35 billion, or 50 percent larger than the earlier estimate. Again, I do not want to imply any criticism of the careful way in which these data are prepared because I am fully aware of the expert and conscientious job that is done by the Department of Commerce in this regard. I think it is important to realize, however, that when figures of this type are used, they should be used with very clear reservations in mind as to their limitations and probable degree of accuracy.

An even more cautious approach to savings figures derived residually is required in trying to interpret quarterly movements of personal saving on a seasonally adjusted annual rate basis where the margin of error can be greatly magnified.

I would now like to focus more closely on the concept of saving. It is possible, subject to statistical discrepancies which are sometimes quite significant, to construct positively the components of personal saving and come reasonably close to adding up to the residually derived personal saving figure that is ordinarily used. Setting aside the statistical problem for the moment, let us look at the composition of saving in this concept.

Individuals, of course, devote a large share of current income to saving in ways other than the common procedure of depositing funds in a financial institution or buying securities issued by the Federal Government, State and local governments, or corporations. For example, they invest directly in tangible assets, such as a home or small business. They save by making monthly payments on a mortgage. Conversely, they engage in what is called "negative saving," or "dissaving," when they borrow money to buy a television set or to build a

51708—60——33

home. Individuals also may decide to carry larger cash balances, represented by more money in their pockets or by keeping larger checking accounts in the banks, as business activity rises. These are all part of the economic definition of saving. Finally, there is another component of saving which involves periodic contributions or contractual payments which to the average consumer will seem to be the same as fixed expenditures. Payments for insurance or contributions to retirement programs are saving of this type.

All of these methods of saving are part of the personal saving component in the national income accounts. It requires quite a stretch of the imagination, however, to consider all of these as directly responsive to overall changes in interest rates. I would like to suggest, therefore, that keeping in mind the qualifications on statistical measurement of interest rates versus savings that I have already mentioned, we examine more carefully the central core of personal saving—the voluntary flow of liquid savings into financial institutions, and the purchase of bonds and notes, which are factors most directly influenced by interest rate changes since they are interest-bearing assets.

The attached table 1 indicates the amount of individuals' funds placed in savings accounts in commercial banks, mutual savings banks, savings and loan association shares, and in fixed dollar corporate, State and local government, and Federal Government securities for each of four 3-year periods, extending from 1948 to 1959. Table 1 also shows the amount of disposable personal income for each of these four periods, together with the percentage going into the particular forms of saving mentioned. The bottom line of table 1 presents the average interest rate on long-term Treasury bonds for the same periods. You will note that each period shows a higher average interest rate than the preceding one. Each period also shows a higher percentage of personal disposable income placed in these directly interest-bearing forms of savings than in the previous period. While I certainly agree that there are many other factors which influence both interest rates and savings, it is clear from table 1 that there is a relationship between these two important economic factors when the concept of interest-bearing savings is used.

We have constructed much the same sort of table in response to part (*b*) of your question, and have done as you suggest in setting up table 2 which shows the demand for long-term investment funds and Government securities in relation to national income. Again, four 3-year periods are presented, since the purpose of the analysis is to identify any longrun relationship. Again, subject to the reservations which I have already indicated, we find that each period shows a higher percentage of national income going into long-term investment funds than in the preceding period.

As was noted above, there is also an upward progression of average interest rates during this 12-year period. Again, as in the case of table 1, there is evidence of an association of higher rates of saving—not just higher absolute saving—with higher interest rates.

In conclusion, therefore, I reiterate that although our statistical tools are not sharp enough to prove conclusively any relationship between interest rates and the volume of saving, they certainly seem to indicate a positive relationship between the two factors when appropriate concepts are relied upon. The data in these two tables, therefore, support the logical thesis that saving will tend to be encouraged by an increase in the interest return—or reward—for saving.

As a closing point I would like to comment briefly on the discussion in your question as to why people save. You are quite correct in concluding, as does the Ford Foundation study, that the purposes for which people save are principally to provide for old age, for a rainy day, for education, for an inheritance, for a vacation, to buy a car, furniture or a house, or to pay off debts. These conclusions in no way, however, suggest whether people save more or less to meet any or all of these purposes when interest rates are high or when they are low. A survey of why people buy automobiles would indicate that the basic reason is transportation, either for business or for pleasure. The answer to that question, however, gives no clue as to either the size or the nature of that demand and it does nothing to refute the simple and readily acceptable proposition that, other things remaining equal, the lower the price of automobiles, the greater the sales. Just as the demand for automobiles will tend to increase as prices fall, so I believe that any thoughtful person will try at least to save more at a higher rate of interest than at a lower rate. Everything else being equal, higher interest rates provide either a more rapid realization of savings goals or support an increase in the goal itself over the same period of time. The power of compound interest is impressive, and more and more people have come to realize, at least in principle, that although it takes 23 years for money to double at 3 percent, it only takes 17½ years at 4 percent, and 14 years at 5 percent.

TABLE 1.—*Interest-bearing individual saving and interest rate trends, calendar years 1948–59*

[Dollar figures are in billions]

	Annual averages			
	1948–50	1951–53	1954–56	1957–59
Increase in interest-bearing assets of individuals:				
Savings deposits:				
In commercial banks	$0.1	$2.2	$2.1	$4.7
In mutual savings banks	.8	1.4	1.9	1.6
In postal savings	–.2	–.2	–.2	–.2
Savings and loan shares [1]	1.5	3.2	5.1	6.2
Bonds and notes:				
U.S. Government	.7	–.2	1.0	1.2
State and local	.6	1.1	1.4	2.0
Corporate and other	(2)	.2	.5	1.2
Total	3.6	7.7	11.8	16.9
Disposable personal income	195.6	239.6	274.7	319.7
Interest-bearing savings to disposable income..percent	1.8	3.2	4.3	5.3
Interest rates on long-term Treasury bonds (percent)	2.36	2.73	2.82	3.66

[1] Includes shares and deposits in credit unions.
[2] Less than $50,000,000.

TABLE 2.—*Net borrowing for investment and Government requirements versus national income and interest rate trends, calendar years 1948–59*

[Dollar figures are in billions]

	Annual averages			
	1948–50	1951–53	1954–56	1957–59
Net borrowing:				
Corporate long-term debt	$5.2	$8.3	$8.7	$10.8
Mortgages	8.0	9.5	14.4	15.6
Government:				
U.S. Government [1]	−1.1	1.4	−1.1	4.3
State and local	2.1	2.6	4.7	4.3
Total	14.2	21.8	26.7	34.9
National income	227.7	292.4	327.6	377.0
Percent net borrowing to national income	6.2	7.5	8.2	9.3
Interest rates on long-term Treasury bonds (percent)	2.36	2.73	2.82	3.66

[1] Change in total amount of publicly held U.S. Government securities.

Question 7

Another question I asked you last summer concerned the reduction in reserve requirements made by the Federal Reserve Board during the first half of the year, the banks' using this added money-creating power to acquire more U.S. securities, and what the difference would be in the Treasury's problem today if the Federal Reserve itself had acquired $10.4 billion of Government securities instead of making credit available to the banks with which to acquire this amount of securities.

I think you may have misunderstood the question. In the first place, your answer states that a $1.5 billion increase in excess reserves assumes an expansion multiplier of 7, but that "on the basis of the usually accepted multiplier of 5 to 6, total expansion of loans and investments * * * would have been between $7.5 and $9 billion, not $10.5 billion.

Second, your answer states that member bank holdings of securities actually rose $6.2 billion during the first half of 1958, not $10.4 billion as is stated in the question.

I think if you will check the Federal Reserve Bulletin for January 1959, page 33—which was my source—you will find that for the last date shown, which is November 26, 1958, all commercial banks increased their holdings of U.S. Government securities from a year earlier by $10.4 billion, and member banks alone increased their holdings by $9.5 billion.

I believe that the multiplier can be computed precisely, but if your staff does not have time for that you may note other information on the same page of the Federal Reserve Bulletin already cited which will show the expansion which did take place. Without arguing the point that nonmember banks share in the credit expansion made possible by a reduction in member bank reserve requirements, let us note the expansion in member bank loans and investments alone. The increase was $14 billion.

The same page of the bulletin shows that total capital accounts in the same period increased from $14,584 million to $15,498 million, or an increase of only $914 million. In other words, only $914 million of the member banks' increased loans and investments could have been

made from stockholders' money, including the bank's surplus and undivided profits.

Finally, you say that my reference to the possibility that the Federal Reserve might have acquired the $10.4 billion of Government securities "is assumed to be a mistake." It was not a mistake; the idea that the Federal Reserve might sometime raise reserve requirements of the member banks, instead of only lowering them, is not, to my mind, unthinkable.

In light of this new understanding of my question, let me rephrase my question as follows:

If the Federal Reserve itself had acquired the $10.4 billion of U.S. Government securities which the commercial banks acquired between November 27, 1957, and November 26, 1958, on credit supplied by the Federal Reserve System, and if the Federal Reserve System had also, in this period, raised reserve requirements of the member banks to the extent that the same amount of credit would have been available to business and consumers as was made available to business and consumers in this period, would the Treasury's problem today be substantially different from what it is, and if so, what would the difference be? (Or if you prefer, the question may be answered in terms of the Federal Reserve's acquiring the $9.5 billion of Government securities which the member banks acquired on Federal Reserve credit.)

Answer

I do not believe that, if the technique described in the question had been used in 1958, the Treasury's problem today would be significantly different from what it is. It is true that Federal Reserve holdings of Government securities at the end of the period indicated in the revised statement of your question, other things remaining equal, would have been some $10.4 billion higher. This in turn would probably result in somewhat higher Federal Reserve earnings and, under current arrangements, a consequent increase in payments by the Reserve Banks to the Treasury. From the standpoint of debt management, however, and as related particularly to the problems arising from operations under a restrictive interest rate ceiling on new issues of Treasury bonds, there would in my judgment be no significant difference. Inasmuch as the overall demand for credit, the availability of savings, and the posture of monetary policy would presumably be the same, there would be no reason to expect lower interest rates in general than actually prevail today.

Moreover, neither the Treasury nor the Federal Reserve can view its problems within the narrow context of the net interest cost of the debt. Increases in reserve requirements in 1958 instead of the decreases that actually occurred could have greatly impeded our efforts to promote economic recovery, even though the same dollar volume of credit expansion might have been possible. This is because reductions in member bank reserve requirements promote a more rapid increase in bank credit and the money supply than does creation of reserves through open market purchases of Government securities. As stated in my answer to your question A-3 of last summer:

"* * * bankers are reluctant to engage in any longrun expansion of assets on the basis of temporary increases in their reserves. When re-

serves are increased through open market purchases, they flow to individual banks by means of the clearing process, and no individual banker can be certain whether his reserve increase is temporary or permanent. He is likely, therefore, to be cautious in lending or investing the additional funds.

"Reductions in reserve requirements, on the other hand, provide a clear indication to the individual banker that he has obtained a specific increase in excess reserves, and this increase can be viewed as something he can depend on. The banker is, therefore, much more likely to lend or invest these additional funds quickly.

"The shortrun effects of a reduction in reserve requirements are likely to be more expansive than open market purchases of securities for still another reason. A reduction in reserve requirements constitutes an overt action on the part of the monetary authorities, clearly identifiable by all observers as a strong, antirecessionary action. Hardly susceptible to misinterpretation, it is a clear indication of the views of the monetary authorities with respect to the economic situation. It implies that no early shift to a restrictive policy is imminent. A reduction in reserve requirements is, in effect, a strong invitation to the banks to expand their loans and investments.

"* * * the significant question relates to the effectiveness of each of these devices in promoting our national economic objectives. Admittedly, reliance on Federal Reserve purchases of Government securities as opposed to reductions in reserve requirements may tend to increase Federal Reserve bank earnings relative to those of member banks, and this in turn might result in a somewhat greater payment of money to the Treasury by the Reserve banks each year. But I am convinced that this amount would be relatively small and, in any event, should not be allowed to influence our judgment with respect to appropriate coordination of credit control instruments in the public interest.

"Reductions in reserve requirements appear to possess certain important advantages in promoting rapid expansion of commercial bank credit during a business recession. This is not to say, however, that this device should be relied upon exclusively as a means of promoting expansion during such periods. The wise course of action would seem to be to continue to assess each situation as it arises; at times, more reliance should be placed on one technique, at times on the other. As in the past, however, it might be expected that both techniques will continue to be utilized together.

"This is simply another way of saying that the monetary authorities should have flexibility in the use of their credit control instruments. It is impossible to forecast in advance the precise conditions that will prevail in a given situation; thus it would be exceedingly unwise to tie the System to a given course of action in advance."

Question 8

In answer to my question No. A-8, with reference to lengthening the maturity of the debt, your answer indicates that there is authority in existing law for the Federal Reserve to exchange short-term obligations with the Treasury for long-term obligations, but that from the Treasury's standpoint "there would be no apparent benefit from a funding operation of this type."

May I ask for an elaboration of your views on this subject as follows:

(*a*) Why is it that you feel the Treasury's financing problem would be greatly relieved if it exchanged long-term obligations to private holders for short-term obligations, but no benefits are to be gained from exchanging long-term obligations for short-term obligations with the Federal Reserve? In other words, as I understand what the Treasury wishes to do, by repealing the interest rate ceiling on long-term securities, is to have more long-term securities outstanding and less short-term securities outstanding, and I fail to see why this would not be accomplished by selling the Federal Reserve long-term securities and withdrawing an equal amount of short-term securities for cancellation.

(*b*) What portion of the $5 billion of Government securities which Congress has authorized the Treasury to sell directly to the Federal Reserve and the Federal Reserve to purchase directly from the Treasury, which may be outstanding at any one time, is now in use; and would there be any benefit from the Treasury's standpoint of utilizing this unused authority to sell long-term securities directly to the Federal Reserve within the present legal interest rate ceiling?

Answer 8(a)

The type of exchange envisaged in this question would not ease the problems of operating under a restrictive interest rate ceiling on new issues of Treasury bonds because the compelling reasons for achieving some lengthening in the maturity of the Federal debt relate almost exclusively to the economic significance of the publicly held debt. For example, a modest amount of shifting of publicly held debt from short- to long-term during a period of inflationary pressures can help limit those pressures, but a lengthening of the portfolio of the Federal Reserve banks, which operate not for profit but in the public interest, would have no such effect. Moreover, continued shortening of the publicly held debt in a period of strong economic activity can actually promote inflationary pressures, because the outstanding Federal debt becomes more like money the closer it moves to maturity. In addition, it is highly important to achieve some lengthening of the maturity structure of the publicly held debt in order to prevent excessive concentration of maturing Treasury securities, which can complicate both debt management and monetary policy. Such concentration of maturities held by the Federal Reserve banks, or by Government investment accounts, does not involve this danger, inasmuch as such issues are almost always exchanged in full for new issues at maturity. The only exception to this practice in recent years has been with respect to "runoffs" of Federal Reserve holdings of maturing Treasury bills in the execution of flexible monetary policies.

Answer 8(b)

None of the authority under section 14(b) of the Federal Reserve Act, which permits the Federal Reserve banks to purchase up to $5 billion in securities directly from the Treasury, is currently in use.

In my judgment, the use of this authority to sell long-term securities directly to the Federal Reserve within the present legal interest rate ceiling of 4¼ percent would be undesirable. The direct purchase authority is properly viewed by both the Federal Reserve and the

Treasury as an emergency authority or to facilitate temporary money market adjustments, usually around tax payment dates (see my replies to your questions 49, 50, and 53 of last summer). This interpretation is supported by the fact that the authority is temporary rather than permanent. The Treasury has emphasized this point in its periodic requests to Congress for renewal of the authority. In other countries, direct recourse of the Treasury to the central bank, on a more or less permanent basis, has led ultimately to severe financial difficulties. The funds created by the central bank in the process of such lending are high powered money and, unless offset by some type of compensatory action, their creation can contribute to strong inflationary pressures.

Moreover, as pointed out in my reply to question 8(*a*), the compelling reasons for achieving some lengthening in the maturity of the Federal debt relate primarily to the economic significance of the publicly held debt. There would be no apparent benefit from extension of the holdings of the Federal Reserve banks, and such extension by use of the direct purchase authority could severely complicate the problem of using monetary policy to promote sustainable economic growth.

Question 9

In answer to my question (A–12) whether high interest rates have caused the big corporations to postpone or cancel their expansion plans, you have answered that "It is doubtful that the range of interest-rate fluctuations during the postwar period has been sufficient to have exerted a significant influence on expansion plans of the larger business corporations."

You add, however, that there is "no doubt" that both interest rates and the credit availability have influenced both the timing and the amount of *total* business capital expenditures.

My question is whether both interest rates *and* the availability of credit have caused the big corporations to postpone or cancel their expansion plans to any substantial extent, or whether substantially all of the postponement or cancellation has fallen on small business?

Answer

There is at present no reliable information to indicate the impact of higher interest rates and restricted credit availability on the expansion plans of business firms, either with respect to all firms or classified by size. To the extent such impact is felt, however, it is reasonable to assume that any differential effects reflects primarily the credit worthiness of the individual business firms, coupled with the credit alternatives open to them.

I am informed that the Federal Reserve System is in the process of assembling information from business concerns which may throw light on this particular question, and that preliminary results of the findings are expected to be available later this year.

Question 10

My question A–13(*a*) was: "Do you agree with the proposition that interest rates should be high in order to hold funds in this country?"

I believe that you must agree that your answer is not the least responsive to the question. You have answered only that "The do-

mestic aspects of high interest rates are more important than their tendency to encourage foreigners to hold funds in this country."

I will concede that in other subsections to question A-13 you have given answers from which one could draw certain conclusions.

First, the Nation's policy is to encourage the flow of U.S. funds to foreign countries, not to try to attract foreign funds to this country. ("* * * we are making substantial amounts of these savings available to undeveloped countries.")

Second, you have also given a plausible explanation as to why there is no great danger that foreign countries will withdraw a large amount of gold from this country (because of "the loss of interest they would undergo by converting earning assets into gold"—since holding gold does not pay interest).

Even so, I believe that a direct answer to the question would go a long way toward stopping the many scare stories appearing in the newspapers and elsewhere by writers who are urging that high interest rates in this country are needed to prevent foreigners from withdrawing their funds from this country, which, it is implied, would drain away our gold and possibly wreck our monetary system.

These scare stories, as you no doubt know, are creating tremendous public support for the present high-interest policy. And while I know of nothing that has been said by you or the Federal Reserve authorities to encourage these scare stories, neither have I observed that either you or the Federal Reserve authorities have said anything to lay the ghost. In other words, it seems to me you are passing up an opportunity to provide public education and enlightenment while your policies are, coincidentally, enjoying tremendous public support based on ignorance and superstition.

Answer

In elaboration of my previous answer to question A-13(a) I should like to make the following points:

The basic element which leads foreigners to hold liquid funds in this country is confidence in the dollar. If confidence in the dollar is maintained, foreigners will hold large amounts of dollars as working balances and as international reserves without the inducement of high interest rates. If confidence in the dollar weakens, foreigners will tend to convert their balances into gold regardless of whether interest rates here are high or low. Foreigners may, of course, convert dollar balances into gold for reasons not directly related to either interest rates or confidence in the dollar. Some countries traditionally hold a relatively fixed proportion of their monetary reserves in the form of gold, and hold dollar balances merely as working capital funds. When they have a surplus of dollar earnings these countries will tend to acquire gold.

Given confidence in the dollar, foreigners may tend to hold somewhat more dollars than they regard as necessary for working balances or international reserves, if interest rates are high relative to those abroad. We do not believe, however, that interest rates should be high in order to hold such additional funds in this country. As noted in our earlier reply: "The domestic aspects of high interest rates are more important than their tendency to encourage foreigners to hold funds in this country." We do think it important that interest rates here be

allowed to reflect the underlying demand for and supply of credit, including the impact of appropriate monetary policies, so as to help keep demand and supply in balance at a stable level of prices.

Question 11

When you appeared before the committee last July, you agreed that you would provide the committee with a study on the subject of the concentration of sales of Treasury issues among a few large purchasers.

More specifically, I believe that you agreed that you would provide a tabulation showing, among other things, the percentage of each type of security issue which has been sold to each of the 50 largest bank purchasers, each of the 50 largest insurance company purchasers, each of the largest dealer purchasers, and each of the largest purchasers among several other types of financial institutions, though it was understood that the committee would not insist upon your identifying each of these big purchasers separately by name. I believe that this information has not yet been submitted, though manifestly the committee's efforts to review and appraise the Treasury's debt management practices, as well as the critical problems in the so-called Government securities market would be greatly aided by such information.

Since our understanding of yesterday is that you will supply immediately answers to the questions I now propose, I will not suggest that you delay the answers to these questions pending the time you can develop the information as to the Treasury's biggest purchasers. I will appreciate it, however, if you know or can quickly obtain the information, your providing preliminary information or estimates on the following:

(*a*) As to the last several long-term issues for which you have information, what percentage of the issue did the Treasury sell to the 50 largest purchasers?

(*b*) As to the last several auctions of Treasury bills for which the Treasury readily has the information, what percentage of the sales were made to the 50 largest purchasers of these bills?

In closing, let me say that I tremendously appreciate your answer to my question A–1, which was whether you think it would be wrong or against the public interest for Congress to express disagreement with the Federal Reserve's monetary policy. Your answer is extremely well put, quite aside from being complimentary of the inquiries which have been made by the Joint Economic Committee and its subcommittees in the past:

"Informed and constructive criticism of Federal Reserve monetary policies is always desirable. This is especially true with respect to the Congress, inasmuch as the Federal Reserve was created by and is responsible to the Congress. * * *

"* * * such studies will tend to stimulate public interest in monetary policy, which is still not widely understood. A continuing interest of the public in monetary policy, along with the broader public understanding that would inevitably follow, is the best possible assurance that monetary policy will continue to be administered in the best interests of all of the people."

Please be assured that I will continue to try to make my criticisms informed and constructive, and I share your view that it is good to stimulate public interest in monetary policy and that a broader public understanding is the best possible assurance that the best interests of all the people will be served.

Answer

In response to your inquiry of last summer, we furnished as complete information as we then had available on new Treasury issues for the classifications you requested. These data, with an accompanying explanatory statement, are published on pages 1105–1131 of the Joint Economic Committee's "Hearings on Employment, Growth, and Price Levels."

Since your question now indicates that you would like to have more detailed information on the subject, we are in the process of determining the problems and cost involved in assembling data as to the participation of the 50 largest investors (without identification) in each of the four classes of financial institutions (commercial banks, mutual savings banks, insurance companies, and dealers and brokers) for each of the 37 marketable issues offered by the Treasury during calendar years 1958 and 1959, but not including 161 separate issues of weekly Treasury bills. These records are located in the files of the Federal Reserve banks and branches throughout the country.

I am sure you will want us to advise you as to the time the assembly of this additional material will require, together with the cost that will be involved in obtaining it. When this latter information has been determined, we will consult with you further.

(Thereupon at 12:45 p.m., the hearings were closed.)

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